

# Annual Report 2017



WORLDWIDE REGIONAL AIRCRAFT LEASING





# Annual Report 2017



This Annual Report contains forward-looking statements within the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. All statements in this Annual Report other than purely historical statements are forward-looking statements. Forward-looking statements in this Annual Report include, without limitation, statements regarding the Company’s plans or intention: to continue a strategy of portfolio modernization in order to achieve a well-balanced portfolio; to become an important player in its market niche; to reduce the average age of its portfolio; to acquire 10- to 12-year old aircraft and manage them for 3-10 years; to grow its presence in the regional airline market with the main focus on mid-life aircraft; to balance its portfolio between turboprop and jets and transition from older to newer generation aircraft; to maintain a diverse customer base; resulting in a higher average aircraft value; to be an opportunistic player in the leasing market; to maintain a diverse customer base and be a reliable long-term partner for regional airlines; to create value for its shareholders; to expand its portfolio to achieve earnings growth while maintaining a manageable level of investment risk; and to have a diversified and balanced portfolio of new and older aircraft on lease to established carriers. The Company’s beliefs, expectations, forecasts, objectives and strategies for the future are not guarantees of future

performance and are subject to risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements, including but not limited to the lack of any unexpected lessee defaults or insolvency; the continued availability of financing for acquisitions; the Company’s success in finding appropriate assets to acquire with such financing; a deterioration of the market or appraised values of aircraft assets owned by the Company; compliance by the Company’s lessees with obligations under their respective leases; and future trends and results that cannot be predicted with certainty. The forward-looking statements in this Annual Report and the Company’s future results of operations are subject to additional risks and uncertainties set forth under the heading “Factors that May Affect Future Results” in documents filed by the Company with the Securities and Exchange Commission, including the Company’s quarterly reports on Form 10-Q and the Company’s latest annual report on Form 10-K, and are based on information available to the Company on the date hereof. The Company does not intend, and assumes no obligation, to update any forward-looking statements made in this Annual Report. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this Annual Report.



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*ACY-owned E175LR on lease to Republic Airline flying for American Eagle on approach to Philadelphia, Pennsylvania*

“During 2017, we modernized our portfolio significantly by selling off engines and older turboprops and jets while investing in newer Embraer jet aircraft. This was on the heels of our 2016 acquisitions of Bombardier CRJ900 and CRJ1000 jet aircraft. In 2018, we will continue this strategy in order to maintain a well-balanced portfolio.”

Michael Magnusson  
CHIEF EXECUTIVE OFFICER



## Message

from Michael Magnusson, Chief Executive Officer



Dear Shareholder:

In this annual report, you will notice not only a new look from previous years' reports, but also expanded information on the company, its philosophy and business approach. I hope you enjoy this additional content.

In 2017, we added another year to AeroCentury's long and successful history in aircraft leasing. We continued our market focus on regional passenger aircraft — generally described as jet or turboprop aircraft with less than 100 passenger seats — and we intend to continue being an important player in this industry niche.

During 2017, we modernized our portfolio significantly by selling off engines and older turboprops and jets while investing in newer Embraer jet aircraft. This was on the heels of our 2016 acquisitions of Bombardier CRJ900 and CRJ1000 jet aircraft. In 2018, we will continue this strategy in order to maintain a well-balanced portfolio.

We are moving up the value chain within our market niche. In 2010, our average aircraft value was approximately \$3 million, but by the end of 2017 the average value had doubled to almost \$7 million. This is a direct result of our conscious decision to focus on aircraft with 50-90 seats, and transition out of smaller aircraft in the 30-50 seat range.

We also want to reduce the average age of our fleet portfolio. Our sweet spot for new acquisitions will be 10- to 12-year-old aircraft, which we plan to hold and manage for 3 to 10 years, assuming market conditions worldwide unfold as we have projected.

These moves are in response to our understanding of the industry gleaned from interacting on many levels with our customer base — regional airlines worldwide. We always seek to learn what our customers are looking for, to be opportunistic in offering what they desire, and to create advantageous leasing and finance structures to help our customers achieve their business goals.

AeroCentury is fortunate to have excellent management and staff, with deep and relevant experience in the industry, who are ready to nurture and grow AeroCentury in 2018 and beyond. We trust you, the shareholder, will continue to support us and share in our excitement for the company's future.

Michael Magnusson  
**CHIEF EXECUTIVE OFFICER**



© Adrian Larsen

*ACY-owned Widerøe Q300 on approach to Kristiansand, Norway*

“AeroCentury has bought approximately 80 and sold 50 regional aircraft since its founding. We have worked with almost 40 regional carriers spread over 6 continents.”

Toni M. Perazzo  
CHIEF FINANCIAL OFFICER

## Message

from Toni M. Perazzo, Chief Financial Officer



Dear Shareholder,

When Neal Crispin and I launched AeroCentury in 1997, we believed that a focus on regional aircraft, which larger leasing companies were mostly ignoring, would create a great business opportunity for the new company. Starting on a small scale with 19- to 50-seat turboprops such as de Havilland Twin Otters and Dash-7s, Fairchild Metros, Shorts 360s and Saab 340As, AeroCentury proved the opportunity for success in this niche was real. We were then able to expand into Fokker F50, Bombardier Dash-8 and Saab 340B aircraft, and to enter the jet market with the acquisition of Fokker F100s.

AeroCentury has bought approximately 80 and sold 50 regional aircraft since its founding. We have worked with almost 40 regional carriers spread over 6 continents. Today, modern regional jets — Bombardier CRJ700/900/1000s and Embraer E175s and E145s — make up the core of AeroCentury's aircraft portfolio. But turboprops, such as the Bombardier Q400, still make up a significant part of our portfolio, giving it balance and diversity in asset type.

As a result of this long history, AeroCentury's wealth of experience and deep relationships with customers, vendors, financial institutions and other players in the aviation industry has become its greatest asset. In looking back over the last 20 years, I am proud of what AeroCentury's experienced and dedicated team has achieved. As many of you know, Neal passed away in January 2016. I think he would be pleased with the current success of the vision we had when founding AeroCentury, and proud of how the company that he guided for so many years has continued to grow and evolve.

AeroCentury enters 2018 as an established and well-respected industry player in the regional aircraft market, and I am excited to see what the future holds.

Thank you for your continued support.

Toni M. Perazzo  
**CHIEF FINANCIAL OFFICER**



## Corporate Profile

AeroCentury Corp. is an aircraft operating lessor and finance company specializing in leasing regional turboprop and jet aircraft to regional airlines. The company's assets consist of a variety of aircraft on lease to regional operators and other commercial users in North America, Europe, Africa, and Asia.

The company utilizes triple net leases of 3 to 10 years in duration. AeroCentury was formed in 1997 by the consolidation of predecessor companies and was listed on the American (now New York) Stock Exchange in January 1998 (NYSE American: ACY).

### Our Management Experience

AeroCentury is proud of its 20 years of aircraft experience with approximately 80 aircraft purchased and 50 sold.

### Vision Going Forward

AeroCentury will continue to grow its presence in the regional airline market with its main focus on mid-life turboprops and regional jets. Our goal is to have a balance between turboprops and regional jets while transitioning from older generation to newer generation aircraft. This will result in a portfolio of aircraft with a higher average value.

AeroCentury remains committed to being a small opportunistic player in the aircraft leasing market. The company aims to maintain a diverse customer base and be a reliable long-term partner for regional airlines.

This vision should result in creating value for our shareholders and a continued role as a trusted supplier to our customers.



*ACY-owned CRJ900 on lease to Jazz flying for Air Canada Express departing from Houston, Texas*

© Bruce Lebowitz | Air Team Images

# Our Team



Michael G. Magnusson  
CHIEF EXECUTIVE OFFICER



Toni M. Perazzo  
CHIEF FINANCIAL OFFICER  
& SECRETARY



Christopher Tigno  
GENERAL COUNSEL



Frank Pegueros  
SENIOR VICE PRESIDENT  
OPERATIONS



Glenn Roberts  
VICE PRESIDENT  
CONTROLLER



Brian Ginna  
VICE PRESIDENT  
CORPORATE DEVELOPMENT



Christopher Hughes  
MANAGER OF TAXATION  
& ACCOUNTING



Harold Lyons  
VICE PRESIDENT  
FINANCE



Hans Middelkoop  
VICE PRESIDENT  
TECHNICAL SERVICES



Tom Stevens  
VICE PRESIDENT  
TECHNICAL SERVICES



Tom Cunningham  
VICE PRESIDENT  
TECHNICAL SERVICES



Zoya Chittum  
EXECUTIVE ASSISTANT



Janet Ratto  
EXECUTIVE ASSISTANT

# Our Board



Evan M. Wallach  
CHAIRMAN



Roy Hahn



David Wilson



Karen Rogge

## Growing Portfolio

Year	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	\$30.7m	\$24.6m	\$29.4m	\$38.2m	\$28.7m	\$38.5m	\$28.7m	\$35.6m
Net Income	\$1.6m	(\$1.5)m	\$5.2m	\$8.3m	(\$11.3)m	\$6.4m	\$1.2m	\$7.4m

Portfolio	\$127m	\$124m	\$144m	\$152m	\$187m	\$155m	\$193m	\$195m
Per Asset	\$2.7m	\$2.8m	\$3.1m	\$3.5m	\$4.8m	\$4.8m	\$6.8m	\$6.8m
Credit Facility	\$90m		\$130m		\$150m			\$170m

Invested	\$9m	\$8m	\$31m	\$25m	\$76m	0	\$54m	\$40m
	Q400	340B+	Q400 S340B+	CRJ705 S340B+	CRJ700 CRJ900 ATR42		CRJ900 CRJ1000	E145 E175
Average Utilization		78%	86%	76%	82%	92%	93%	93%



*ACY-owned CRJ700ER leased to American Airlines flying for American Eagle on approach to Philadelphia, Pennsylvania*

### Pioneer in Leasing Regional Aircraft

Founded in 1997 by the late Neal Crispin, AeroCentury has firmly followed its mission as trailblazer in leasing regional aircraft around the world. The company's stock was listed on what is now the NYSE American Stock Exchange in January 1998, and is the only publicly traded company focusing exclusively on regional aircraft leasing.

Today, AeroCentury's portfolio has been modernized to include Bombardier CRJ700/900/1000 regional jets, as well as Embraer E175s, and Bombardier Q400 high-speed turboprops.



## Portfolio Evolution

Year:	2010	2011	2012	2013	2014	2015	2016	2017
<b>TURBOPROPS</b>								
DHC-6	3	1	1					
S340A	4	3	2	2				
S340B	4	4	4	3	1	1	1	1
S340Bplus		2	4	6	6	5	5	4
DHC8-100	2	2	1					
DHC8-300	8	8	9	9	8	6	6	6
Q400	1	1	3	3	3	3	3	2
F50	14	14	13	10	7	6	3	3
ATR42-600					1	1		

<b>JETS</b>								
F100	7	7	7	7	7	6	2	
CRJ705 (900)				1	1	1	1	1
CRJ701ER					3	3	3	3
CRJ900					2	2	4	4
CRJ1000							2	2
E145								3
E175LR								3

<b>ENGINES</b>	3	3	4	6	5	5	4	1
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Total Aircraft	43	42	44	41	39	34	30	32
% JET value	30%	28%	22%	31%	45%	46%	66%	76%



ACY-owned CRJ1000 on lease to Air Nostrum flying for Iberia Regional on approach to Toulouse, France

## AeroCentury Geographical Spread

(32 aircraft and 9 customers as of 12/31/17)



ACY-owned CRJ900LR climbing away from Munich, Germany

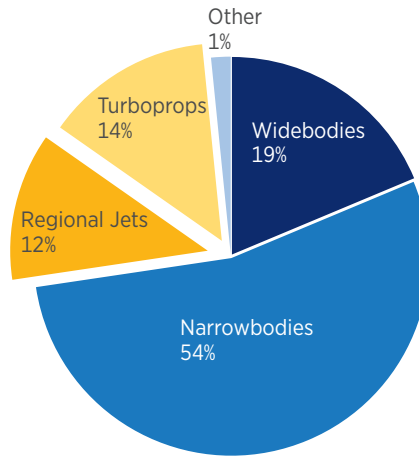
## AeroCentury Past Customers



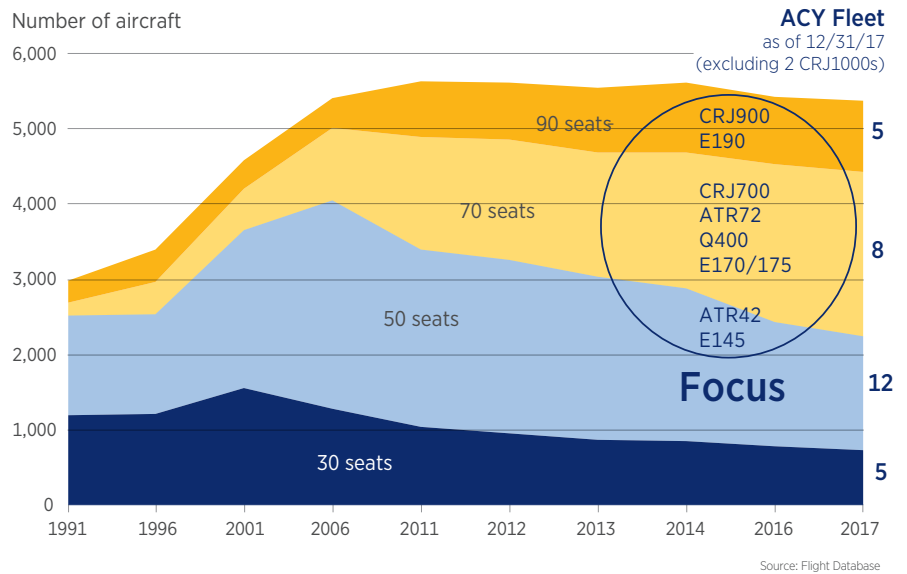
ACY-owned Q400 operated by LAM in Mozambique, Africa



## GLOBAL COMMERCIAL AIRCRAFT FLEET — 28,000



### FLEET FOCUS (30-90 seat)



#### Global Aircraft Key Facts & Figures

- ~15,000 narrowbodies of which about 7,500 leased
- ~5,000 widebodies of which about 1,800 leased
- ~3,500 regional jets of which about 1,200 leased
- ~4,000 turboprops of which about 1,100 leased
- ~300 “other” specialized aircraft

### Business Strategy

AeroCentury is an established lessor of 30- to 90-seat regional aircraft. Its business model is to carefully expand its portfolio of leased aircraft to achieve earnings growth while maintaining a manageable level of investment risk. The goal is to have a diversified and balanced portfolio of new and older aircraft on lease to established air carriers worldwide.

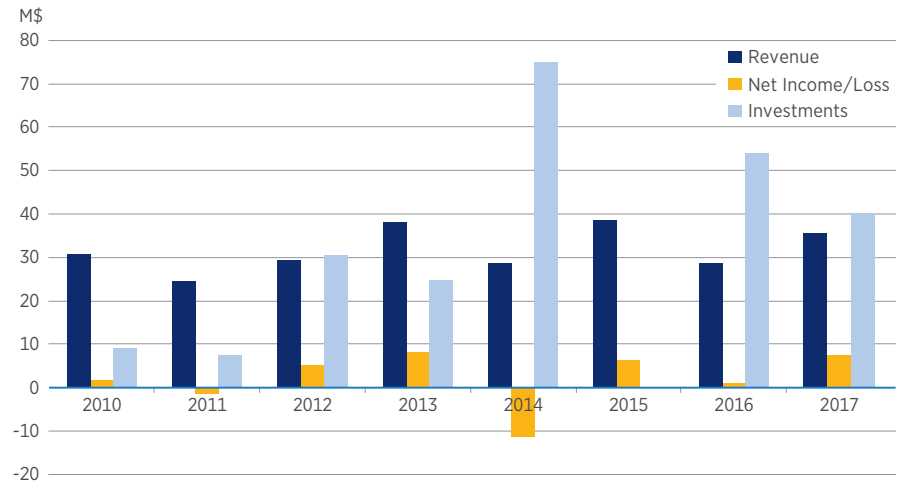
While historically the airline industry is cyclical, the regional airline market traditionally has fared better during economic downturns compared to the larger carriers because regional airlines tend to be resilient, opportunistic, and flexible in handling their cost structures.



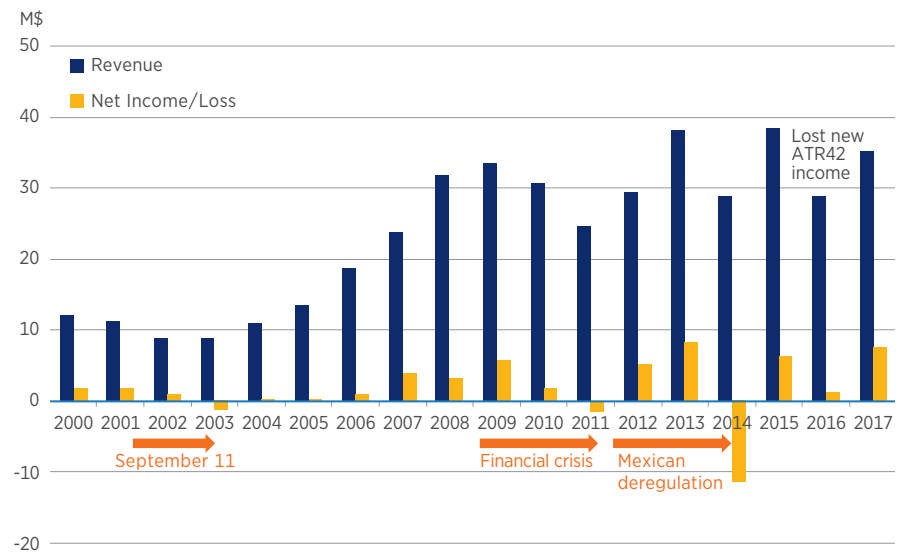
### ACY Key Facts and Figures (12/31/17)

- \$219 million total aircraft assets
- 32 aircraft, 1 engine
- \$47 million equity, or \$33 per share
- 9 customers in 8 countries

### AEROCENTURY INVESTMENT HISTORY Over \$240m Invested



### AEROCENTURY PROFITABLE HISTORY



### Different Leasing Models

AeroCentury carefully monitors market trends in the aircraft leasing markets, identifying three main market segments and business models.

The new aircraft market requires lessors to have significant capital and only is viable for lessors buying in large volume. The customers are top tier airlines in a highly competitive segment.

In comparison, the mid-life aircraft segment is less competitive, with a focus on mid- and lower tier

airlines. The key factor for lessor success is to buy right and sell at the right time. This segment is AeroCentury's main focus.

Players in the older aircraft market segment focus on short-term leases and parting out only. As a result, this segment requires lessors to have extensive resources to store and sell parts.

## Summary of 2017

A recap of 2017 versus 2016 shows that AeroCentury's total revenue is up 24% (\$35.6 million versus \$28.7 million). Expenses increased 20% to \$32.1 million; however, maintenance costs were reduced and no bad debt was recorded in 2017, compared to 2016.

Net income in 2017 was \$7.4 million which included a \$5.4 million tax benefit from the revaluation of the company's deferred tax liability caused by the passage of the Tax Cuts and Jobs Act of 2017. The portfolio's net book value increased to \$219 million. The utilization of the portfolio remained at 93%.

AeroCentury invested \$40 million in newer Embraer regional jets, including 3 E145s and 3 E175s, compared with \$54 million in 2016.

During 2017, AeroCentury recorded \$13.7 million in sales owing to the sale of 1 Saab 340Bplus, 2 CF34-8E engines, 2 CT7-9 engines, 2 F100s and a Q400 gear and parts.

The company's credit line was increased by \$20 million to \$170 million.









UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

**FORM 10-K**

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **001-13387**

**AeroCentury Corp.**

(Exact name of Registrant as Specified in Its Charter)

**Delaware**

**94-3263974**

(State or Other Jurisdiction of Incorporation or Organization)

(IRS Employer Identification No.)

**1440 Chapin Avenue, Suite 310**

**Burlingame, California 94010**

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: **(650) 340-1888**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, par value \$0.001 per share

NYSE American Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The aggregate market value of the voting and non-voting common equity held by non-affiliates (based upon the closing price as of June 30, 2017) was \$12,966,200.

The number of shares of the Registrant’s Common Stock outstanding as of March 8, 2018 was 1,416,699.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Part III of this Annual Report on Form 10-K incorporates information by reference from the Registrant’s Proxy Statement for its 2018 Annual Meeting of Stockholders. Except as expressly incorporated by reference, the Registrant’s Proxy Statement shall not be deemed to be a part of this Annual Report on Form 10-K.



## PART I FINANCIAL INFORMATION

### *Forward-Looking Statements*

This Annual Report on Form 10-K includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All statements in this Report other than statements of historical fact are “forward-looking statements” for purposes of these provisions, including any statements of plans and objectives for future operations and any statements of assumptions underlying any of the foregoing. Statements that include the use of terminology such as “may,” “will,” “expects,” “plans,” “anticipates,” “estimates,” “potential,” or “continue,” or the negative thereof, or other comparable terminology are forward-looking statements. Forward-looking statements include these statements: (i) in Part I, Item 1, “Business of the Company,” that the Company can purchase assets at an appropriate price and maintain an acceptable overall on-lease rate for the Company’s assets; and that it is able and willing to enter into transactions with a wider range of lessees than would be possible for traditional, large lending institutions and leasing companies; (ii) in Part I, Item 1, “Working Capital Needs,” that the Company will have sufficient cash flow to cover its expenses and provide excess cash flow; and that if the Company incurs unusually large maintenance costs or reimbursements for maintenance in any given period, the Company will have sufficient cash flow or borrowing availability under its credit facility to fund such maintenance; (iii) in Part I, Item 1, “Competition,” that the Company has a competitive advantage due to its experience and operational efficiency in financing the transaction sizes that are desired by many in the regional air carrier market; and that the Company continues to have a competitive advantage because JMC has developed a presence as a global participant in the regional aircraft leasing market; (iv) in Part I, Item 1, “Environmental Matters,” that neither compliance with federal, state and local provisions regulating discharge of greenhouse gas emissions (including carbon dioxide (CO<sub>2</sub>)) in the environment and/or aircraft noise regulations, nor remedial agreements or other actions relating to the environment, has had, or is expected to have, a material effect on the Company’s capital expenditures, financial condition, results of operations or competitive position; (v) in Part I, Item 3, “Legal Proceedings,” that none of the current litigation, if resolved adverse to the Company, is anticipated to have a material adverse effect on the Company; (vi) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Overview,” that if the Merger is consummated, the Company will record a settlement loss related to its existing obligations under the management agreement with JMC on the Merger closing date in an amount equal to a substantial portion of the purchase consideration to be paid as part of the Merger; and that the Merger is expected to occur in early April 2018; (vii) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations,” that the most significant effect to the Company of the Tax Cut and Jobs Act of 2017 is expected to be the reduced corporate tax rate; (viii) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources,” that available borrowings under the Credit Facility will be sufficient to meet its continuing obligations and, if the Credit Facility is expanded from its current amount of \$170 million to the maximum of \$180 million, to fund anticipated acquisitions; that the revised covenant limits agreed to in the modification to the Company’s credit facility covenants are sufficient to avoid causing a default under the loan agreement; and that the Company will have adequate cash flow to meet its ongoing operational needs, including any required repayments under the Credit Facility; (ix) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Outlook”, that the Merger with JetFleet Holding Corp. is anticipated to be consummated early in the second quarter of 2018; that the combination of the management function performed by JMC and the portfolio held by the Company will be accretive to the Company and will create shareholder value for the shareholders of the combined post-Merger company, but such accretion may not be realized until after transaction and integration costs in connection with the Merger have been incurred; that the elimination of the outside management company structure removes a key impediment to capital raising by the Company; that the Company will incur certain non-recurring Merger expenses in the periods leading up to the Merger, and immediately following, as well as having to record, for accounting purposes, a settlement loss at the time of consummation of the Merger, which could negatively affect the Company’s results for those periods; that the Company anticipates the trend of higher acquisition prices and lower lease rates, margins and fewer acquisition opportunities will continue for the short- to medium-term, until yields on alternative investments return to a more normal historical range; and that the Company is competitive because of JMC’s expertise and operational efficiency in identifying and obtaining financing for the transaction types desired by regional air carriers; (x) in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Factors that May Affect Future Results”, that the Company will be in compliance with all of its credit facility covenants; that if

the acquisition by merger of JHC is consummated, the Company will record a settlement loss related to its existing obligations under the management agreement with JMC on the closing date of the Merger in an amount equal to a substantial portion of the purchase consideration to be paid in the Merger; that the credit line modifications made are sufficient to avoid the settlement loss and merger costs from causing a default under the Credit Facility financial covenants; that even if the credit facility limit were increased, in order to utilize the higher limit, the Company would need to source additional equity capital in order to remain in compliance with the debt to equity ratio covenant to utilize the higher limit; that the Company will have sufficient cash funds to make any required principal repayment that arises due to any credit facility borrowing limitations; that as competition increases, it will likely continue to create upward pressure on acquisition prices for many of the aircraft types that the Company has targeted to buy and, at the same time, create downward pressure on lease rates, resulting in lower margins for the Company and, therefore, fewer acceptable acquisition opportunities for the Company; that the Company does not anticipate any worsening of the financial condition of its overall customer base, but believes that there may be further shakeouts of weaker carriers in economically troubled regions; that most of the Company's growth will be outside North America; that the Company intends to continue to focus solely on regional aircraft; that the Company may continue to seek acquisition opportunities for new types and models of aircraft used in the Company's targeted customer base of regional air carriers but that the Company's overall industry expertise may permit the Company to effectively manage such new aircraft types; that if the Merger is consummated, the Company would have control over JMC's operations and it is expected that the risks of conflicts of fiduciary duty would be largely mitigated; that there are effective mitigating factors against undue compensation-incented risk-taking by JMC; that the burden and cost of complying with governmental requirements will fall primarily upon lessees; that it is not expected that the costs of complying with current environmental regulations will have a material adverse effect on the Company's financial position, results of operations, or cash flows; that the Company's main vulnerability to a cyber-attack would be interruption of the Company's email communications internally and with third parties, loss of customer and lease archives, and loss of document sharing between the Company's offices and remote workers; that the Company has sufficient cyber-security measures in place commensurate with the risks to the Company of a successful cyber-attack or breach of security; and that sufficient replacement mechanisms exist in the event of such a cyber-attack interruption that there would not be a material adverse financial impact on the Company's business; (xi) in Part II, Item 8, "Financial Statements," that the Company does not expect to adopt ASU 2016-02 early, and expects to elect practical expedients in connection with its adoption, including not re-evaluating lease classification or capitalized initial direct costs on existing leases; that the Company expects to account for the acquisition using the acquisition method of accounting, whereby the purchase price will be allocated to the assets acquired and liabilities assumed based on their respective fair values as of the acquisition date; that the Company expects that it will be required, for accounting purposes, to record, at the time of acquisition, a substantial portion of the Merger consideration paid for JHC as a settlement loss arising from the deemed extinguishment of the obligation to pay fees to JetFleet Management Corp. ("JMC") under the management agreement between the Company and JMC, since any fees paid to JMC post-Merger under the management agreement will be treated as intercompany transfers; that the outcome of any existing or known threatened proceedings, even if determined adversely, should not have a material adverse effect on the Company's business, financial condition, liquidity or results of operations; and that it is more than not that the Company's entire deferred federal income tax asset will be realized; that the Company expects to utilize the net operating loss carryovers remaining at December 31, 2017 in future years. These forward-looking statements involve risks and uncertainties, and it is important to note that the Company's actual results could differ materially from those projected or assumed in such forward-looking statements. Among the factors that could cause actual results to differ materially are the factors detailed under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations — Factors That May Affect Future Results," including no sudden current economic downturn or unanticipated future financial crises or other unanticipated events, such as war, terrorist events or a flu epidemic that might adversely affect the travel industry or the commercial airline business, the lack of any unexpected lessee defaults or insolvency; a deterioration of the market values of aircraft types owned by the Company; compliance by the Company's lessees with obligations under their respective leases; the continued availability of financing for acquisitions under the Credit Facility; the Company's success in finding appropriate assets to acquire with such financing; deviations from the assumption that future major maintenance expenses will be relatively evenly spaced over the entire portfolio; and future trends and results which cannot be predicted with certainty. The cautionary statements made in this Report should be read as being applicable to all related forward-looking statements wherever they appear herein. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to the Company as of the date hereof, and the Company assumes no obligation to update any forward-looking statement or risk factor. You should consult the risk factors listed from time to time in the Company's filings with the Securities and Exchange Commission.

## **Item 1. Business.**

### *Business of the Company*

AeroCentury Corp., a Delaware corporation incorporated in 1997, typically acquires used regional aircraft for lease to regional carriers worldwide. In August 2016, AeroCentury Corp. formed two wholly-owned subsidiaries, ACY 19002 Limited (“ACY 19002”) and ACY 19003 Limited (“ACY 19003”) for the purpose of acquiring aircraft using a combination of cash and financing separate from the parent’s credit facility.

The business of AeroCentury Corp., ACY 19002 and ACY 19003 (collectively, the “Company”) is managed by JetFleet Management Corp. (“JMC”), pursuant to a management agreement (the “Management Agreement”) with JMC. JMC is an integrated aircraft management, marketing and financing business and a subsidiary of JetFleet Holding Corp. (“JHC”). Certain officers of the Company are also officers of JHC and JMC and hold significant ownership positions in both JHC and the Company. As discussed in Item 7 – “Overview,” below, the Company has entered into an Agreement and Plan of Merger to acquire JHC for a combination of stock and cash consideration (the “Merger”). The Merger has not been consummated and factors concerning it are discussed below under Item 7 – “Outlook,” as well as in Notes 7 and 13 to the Company’s consolidated financial statements in Item 8 of this Annual Report on Form 10-K.

Since its formation, the Company has been engaged in the business of investing in used regional aircraft equipment leased to foreign and domestic regional air carriers. The Company’s principal business objective is to increase stockholder value by acquiring aircraft assets and managing those assets in order to provide a return on investment through lease revenue and, eventually, sale proceeds. The Company strives to achieve its business objective by reinvesting cash flow and using short-term and long-term debt and/or equity financing.

The Company’s success in achieving its objective depends in large part on its success in three areas: asset selection, lessee selection and obtaining financing for acquisition of aircraft and engines.

The Company typically acquires assets in one of three ways. The Company may purchase an asset already subject to a lease and assume the rights and obligations of the seller, as lessor under the existing lease. Additionally, the Company may purchase an asset from an air carrier and lease it back to the air carrier. Finally, the Company may purchase an asset from a seller and then immediately enter into a new lease for the aircraft with a third party lessee. In this last case, the Company typically does not purchase an asset unless a potential lessee has been identified and has committed to lease the asset.

The Company generally targets used regional aircraft with purchase prices between \$10 million and \$20 million, and lease terms of three to ten years. In determining assets for acquisition, the Company evaluates, among other things, the type of asset, its current price and projected future value, its versatility or specialized uses, the current and projected availability of and demand for that asset, and the type and number of future potential lessees. Because JMC has extensive experience in purchasing, leasing and selling used regional aircraft, the Company believes it can purchase these assets at an appropriate price and maintain an acceptable overall on-lease rate for them.

In order to improve the remarketability of an aircraft after expiration of a lease, the Company’s leases generally contain provisions that require lessees to either return the aircraft in a condition that allows the Company to expediently re-lease or sell the aircraft, or pay sufficient amounts based on usage under the lease to cover any maintenance or overhaul of the aircraft required to bring the aircraft to such a state.

When considering whether to enter into transactions with a lessee, the Company generally reviews the lessee’s creditworthiness, growth prospects, financial status and backing; the experience of its management; and the impact of legal and regulatory matters in the lessee’s market, all of which are weighed in determining the lease terms offered to the lessee. In addition, it is the Company’s policy to monitor the lessee’s business and financial performance closely throughout the term of the lease, and, if requested, provide assistance drawn from the experience of the Company’s management in many areas of the air carrier industry. Because of its “hands-on” approach to portfolio management, the Company believes it is able and willing to enter into transactions with a wider range of lessees than may be possible for traditional, large lending institutions and leasing companies.

The Company has funded its asset acquisitions primarily through debt financing supplemented by free cash flow. The Company's primary source of debt financing has been a secured credit facility. The Company's current credit facility (the "Credit Facility") is provided by a syndicate of banks, with MUFG Union Bank, N.A. as agent, and expires on May 31, 2019. As discussed above, during 2016, the Company also financed the purchase of two aircraft using special purpose financing.

### *Working Capital Needs*

The Company's portfolio of assets has historically generated revenues that have exceeded the Company's cash expenses, which consist mainly of management fees, maintenance costs, principal and interest payments on debt, professional fees, and insurance premiums.

The management fees paid by the Company to JMC are based upon the book value of the Company's asset pool. Maintenance costs for off-lease aircraft are recognized as expenses as incurred, while reimbursement of lessee maintenance costs from previously collected maintenance reserves reduce the Company's maintenance reserves liability. Interest expense is dependent on both the balance of the Company's indebtedness and applicable interest rates. Professional fees are paid to third parties for expenses not covered by JMC under the Management Agreement. Insurance expense includes amounts paid for directors and officers insurance, as well as product liability insurance and aircraft hull insurance for periods when an aircraft is off lease.

So long as the Company succeeds in keeping the majority of its assets on lease and interest rates do not rise significantly and rapidly, the Company's cash flow should continue to be sufficient to cover its expenses and provide excess cash flow. If the Company incurs unusually large maintenance costs or reimbursements for maintenance in any given period, the Company expects it will have sufficient cash flow or borrowing availability under its credit facility to fund such maintenance.

### *Competition*

The Company competes with other leasing companies, banks, financial institutions, private equity firms, and aircraft leasing syndicates for customers that generally are regional commercial aircraft operators seeking to lease aircraft under operating leases. Competition has increased as competitors who have traditionally neglected the regional air carrier market have recently focused on that market. The industry has also experienced a number of consolidations of smaller leasing companies, creating a handful of very large companies operating in this market. Because competition is largely based on price and lease terms, the entry of new competitors into the market, the creation of larger competitors due to consolidation, and/or the entry of traditional large aircraft lessors into the regional aircraft niche, particularly those with greater access to capital markets than the Company, could lead to fewer acquisition opportunities for the Company and/or lease terms less favorable to the Company, as well as fewer renewals of existing leases or new leases of existing aircraft, all of which could lead to lower revenues, profitability and cash flow for the Company.

The Company, however, believes that it has a competitive advantage due to its experience and operational efficiency in financing the transaction sizes that are desired by many in the regional air carrier market. Management believes that the Company also continues to have a competitive advantage as a global participant in the regional aircraft leasing market.

### *Dependence on Significant Customers*

For the year ended December 31, 2017, the Company's four largest customers accounted for 28%, 20%, 14%, and 11% of lease revenue. For the year ended December 31, 2016, the Company's three largest customers accounted for 21%, 17%, and 17% of lease revenue. Concentration of credit risk with respect to lease receivables will diminish in the future only if the Company is able to expand the customer base by re-leasing assets currently on lease to significant customers to new customers and/or acquire assets for lease to new customers.



## *Environmental Matters*

Neither compliance with federal, state and local provisions regulating discharge of greenhouse gas emissions (including carbon dioxide (CO<sub>2</sub>)) in the environment and/or aircraft noise regulations, nor remedial agreements or other actions relating to the environment, has had, or is expected to have, a material effect on the Company's capital expenditures, financial condition, results of operations or competitive position.

## *Employees*

Under the Company's Management Agreement, JMC is responsible for all administration and management of the Company. Consequently, the Company does not have any employees. This is expected to change when the Merger is consummated and the Company assumes responsibility for administration and management of the Company.

## *Available Information*

The headquarters of AeroCentury Corp. is located at 1440 Chapin Avenue, Suite 310, Burlingame, California 94010. The main telephone number is (650) 340-1888. The Company's website is located at: <http://www.aerocentury.com>.

The Company is subject to the reporting requirements of the Securities Exchange Act (the "Exchange Act"). Therefore, the Company files periodic reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). Copies of these materials, filed by us with the SEC, are available free of charge on the Company's website at [www.aerocentury.com](http://www.aerocentury.com) through the Investor Relations link (SEC Filings). The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room of the SEC at 100 F Street N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

## **Item 1A. Risk Factors.**

Smaller reporting companies are not required to provide this information.

## **Item 1B. Unresolved Staff Comments.**

None.

## **Item 2. Properties.**

As of December 31, 2017, the Company did not own or lease any real property, plant or materially important physical properties. The Company maintains its principal office at 1440 Chapin Avenue, Suite 310, Burlingame, California 94010. However, since the Company has no employees and the Company's portfolio of leased aircraft assets is managed and administered under the terms of the Management Agreement with JMC, all office facilities are provided by JMC.

For information regarding the aircraft and aircraft engines owned by the Company, refer to Notes 2 and 3 to the Company's consolidated financial statements in Item 8 of this Annual Report on Form 10-K.

## **Item 3. Legal Proceedings.**

The Company from time to time engages in ordinary course litigation relating to lease collection matters against defaulting lessees and mechanic's lien claims by vendors hired by lessees. None of the current litigation, if resolved adverse to the Company, is anticipated to have a material adverse effect on the Company's financial condition or results of operations.

## **Item 4. Mine Safety Disclosures.**

Not applicable.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The shares of the Company's Common Stock are traded on the NYSE American exchange ("NYSE American") under the symbol "ACY."

#### *Market Information*

The Company's Common Stock has been traded on the NYSE American exchange, formerly known as NYSE MKT and the American Stock Exchange, since January 16, 1998. The following table sets forth the high and low sales prices reported on the NYSE American exchange for the Company's Common Stock for the periods indicated:

Period	High	Low
Fiscal year ended December 31, 2017:		
Fourth Quarter	\$15.75	\$12.05
Third Quarter	16.10	10.10
Second Quarter	13.10	9.65
First Quarter	11.10	9.00
Fiscal year ended December 31, 2016:		
Fourth Quarter	9.69	8.50
Third Quarter	9.50	8.50
Second Quarter	11.45	8.52
First Quarter	14.88	10.03

On March 7, 2018, the closing sale price of the Company's Common Stock on the NYSE American exchange was \$15.40 per share.

#### *Sale of Unregistered Securities*

In April 2007, the Company issued warrants to purchase up to 81,224 shares of the Company's Common Stock at \$8.75 per share. On December 16, 2015, the holders of the warrants exercised all warrants outstanding on a "cashless" basis, resulting in the issuance on that date of 23,442 net shares of Common Stock. Such shares of Common Stock were issued pursuant to an exemption from registration under Section 3(a)(9) of the Securities Act of 1933, as amended (the "Securities Act"), and no underwriters were used in connection with the warrant exercise. The 23,442 shares issued to the holders of the warrants may be resold by such holders under an exemption from registration provided by Rule 144 under the Securities Act.

#### *Number of Security Holders*

According to the Company's transfer agent, the Company had approximately 1,300 stockholders of record as of March 8, 2018. Because brokers and other institutions on behalf of beneficial stockholders hold many of the Company's shares of Common Stock, the Company is unable to estimate the total number of beneficial stockholders represented by those record holders.

#### *Dividends*

No dividends have been declared or paid to date. The Company has no plans at this time to declare or pay dividends, and intends to re-invest any earnings into the acquisition of additional revenue-generating aircraft equipment.

The terms of the Credit Facility prohibit the Company from declaring or paying dividends on its Common Stock, except for cash dividends in an aggregate annual amount not to exceed 50% of the Company's net income in the immediately preceding fiscal year so long as immediately prior to and immediately following such dividend the Company is not in default under the Credit Facility.

## *Stockholder Rights Plan*

For information regarding the Company's stockholder rights plan, refer to Note 8 to the Company's consolidated financial statements in Item 8 of this Annual Report on Form 10-K.

## **Item 6. Selected Financial Data.**

This report does not include information described under Item 301 of Regulation S-K pursuant to the rules of the SEC that permit "smaller reporting companies" to omit such information.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

### *Overview*

The Company provides leasing and finance services to regional airlines worldwide. The Company is principally engaged in providing leasing services of mid-life regional aircraft to carriers, including operating leases and finance leases. In addition to leasing activities, the Company sells aircraft from its operating lease portfolio to third parties, including other leasing companies, financial services companies, and airlines, as well as "parting out" aircraft when that is deemed the most profitable means of disposal. The Company's operating performance is driven by the growth of its aircraft portfolio, the terms of its leases, the interest rate of its debt, as well as asset sales.

On October 26, 2017, the Company entered into an Agreement and Plan of Merger to acquire JHC, the corporate parent of JMC, the Company's management company, for a combination of stock and cash consideration. The Merger has not been consummated and factors concerning it are discussed below under "Outlook" as well as in Notes 7 and 13 to the Company's consolidated financial statements in Item 8 of this Annual Report on Form 10-K. The Company believes that if the Merger is consummated, it will record a settlement loss related to its existing obligations under the management agreement with JMC on the Merger closing date in an amount equal to a substantial portion of the purchase consideration to be paid as part of the Merger. The amount of the loss cannot be ascertained exactly until the Merger closes, as it depends on several variables, including final adjustments to the agreed purchase price and the quoted market price of AeroCentury Common Stock on the Merger closing date, which is expected to occur in early April 2018.

During 2017, the Company purchased three aircraft subject to operating leases. During the same period, the Company sold an aircraft and three engines for cash, exchanged one of its spare engines for 150,000 shares of the Company's common stock held by a stockholder, and reclassified an airframe and one of its engines at lease termination to held for sale for parts, while the second engine remains held for lease. The Company also reclassified an aircraft that had previously been held for sale to held for lease. The Company ended the year with a total of twenty-three aircraft and one engine held for lease, with a net book value of approximately \$195 million. This represents a 1% increase compared to the net book value at December 31, 2016. The Company also ended the year with nine aircraft subject to finance leases, of which three were acquired in 2017.

The Company currently has a customer base of nine airlines in eight countries. Average portfolio utilization was approximately 93% during 2017 and 2016.

During 2017, the Company expanded its revolving credit facility to \$170 million. The unused amount of the Credit Facility was \$36 million as of December 31, 2017. The weighted average interest rate on the Credit Facility was 5.21% at December 31, 2017.

Total revenues and other income of \$35.6 million increased by \$6.8 million compared to 2016, primarily as a result of increased operating lease, finance lease and maintenance reserves revenues, the effects of which were substantially offset by decreased gains from asset dispositions.

As discussed in *Results of Operations*, below, the Company recorded a \$5.4 million decrease in tax expense in 2017 as a result of the Tax Cuts and Jobs Act of 2017 (the "Act").

Net income for 2017 was \$7.4 million, compared to net income of \$1.2 million in 2016, resulting in basic and diluted earnings per share of \$5.10 and \$0.78 respectively. Pre-tax profit margin was 10% in 2017 compared to 7% in 2016. Expenses for 2017 expenses included \$619,400 of legal and advisory expenses incurred in connection with the proposed acquisition of JHC by the Company.

### *Fleet Summary*

The Company operates in one business segment, the leasing of regional aircraft and engines to foreign and domestic regional airlines, and therefore does not present separate segment information for lines of business.

Portfolio metrics of the Company's assets held for lease as of December 31, 2017 and December 31, 2016 were as follows.

	December 31, 2017	December 31, 2016
Number of aircraft and aircraft engines held for lease	24	28
Weighted average fleet age	11.4 years	11.3 years
Weighted average remaining lease term	58 months	59 months
Aggregate fleet net book value	\$195,098,200	\$192,799,800
	For the Years Ended December 31,	
	2017	2016
Average portfolio utilization	93%	93%



The following table sets forth the net book value and percentage of the net book value, by type, of the Company's assets that were held for lease at December 31, 2017 and December 31, 2016.

Type	December 31, 2017		December 31, 2016	
	Number owned	% of net book value	Number owned	% of net book value
Turboprop aircraft:				
Bombardier Dash-8-400	2	7%	3	11%
Bombardier Dash-8-300	3	6%	3	6%
Saab 340B Plus	4	3%	5	5%
Saab 340B	1	1%	-	-
Fokker 50	-	-	1	1%
Regional jet aircraft:				
Canadair 900	4	31%	4	33%
Embraer 175	3	16%	-	-
Canadair 1000	2	15%	2	16%
Canadair 700	3	13%	3	14%
Canadair 705	1	7%	1	8%
Fokker 100	-	-	2	2%
Engines:				
Pratt & Whitney 150A	1	1%	-	-
General Electric CF34-8E5A1	-	-	2	3%
General Electric CT7-9B	-	-	2	1%

At December 31, 2017, and December 31, 2016, the Company also had nine aircraft and five aircraft, respectively, subject to finance leases.

The following table sets forth the net book value and percentage of the net book value of the Company's assets that were held for lease at December 31, 2017, and December 31, 2016, in the indicated regions:

Region	December 31, 2017		December 31, 2016	
	Net book value	% of net book value	Net book value	% of net book value
Europe	\$ 92,108,500	47%	\$105,088,300	55%
North America	72,270,700	37%	42,824,300	22%
Asia	6,082,100	3%	6,463,700	3%
Africa	-	-	21,724,400	11%
Australia	-	-	3,585,900	2%
Off lease	24,636,900	13%	13,113,200	7%
	<u>\$195,098,200</u>	<u>100%</u>	<u>\$192,799,800</u>	<u>100%</u>

For the year ended December 31, 2017, approximately 28%, 21%, 20%, and 11% of the Company's operating lease revenue was derived from customers in Slovenia, the United States, Spain and Mozambique, respectively. For the quarter ended December 31, 2017, approximately 29%, 28%, and 21% of the Company's operating lease revenue was derived from customers in Slovenia, the United States, and Spain, respectively. Operating lease revenue does not include interest income from the Company's finance leases.

The following table sets forth geographic information about the Company's operating lease revenue for leased assets, grouped by domicile of the lessee:

Region	For the Years Ended December 31,			
	2017		2016	
	Number of lessees	% of operating lease revenue	Number of lessees	% of operating lease revenue
Europe	4	52%	5	41%
North America	5	29%	3	28%
Africa	1	12%	2	18%
Asia	1	4%	2	7%
Australia	1	3%	1	5%
South America	-	-	1	1%

For the year ended December 31, 2017, approximately 75% and 25% of the Company's finance lease revenue was derived from customers in Africa and Europe, respectively. For the quarter ended December 31, 2017, approximately 70% and 30% of the Company's finance lease revenue was derived from customers in Africa and Europe, respectively.

### *Results of Operations*

During 2017, the Company acquired three regional jet aircraft that are on lease pursuant to operating leases and three regional jet aircraft that are subject to direct financing leases. During 2016, the Company acquired four regional jet aircraft, all of which are subject to operating leases.

During 2017, the Company sold two regional jets, one turboprop aircraft and three spare engines that had been held for lease. The Company also exchanged one of its spare engines for 150,000 shares of common stock of the Company held by a stockholder. During 2016, the Company sold four regional jet aircraft that had been held for sale, and, pursuant to sales-type finance leases, an additional three turboprop aircraft that had been held for lease.

Total revenues and other income increased by 24% to \$35.6 million in 2017 from \$28.7 million in 2016.

Operating lease revenue increased 19% to \$29.0 million in 2017 from \$24.5 million in 2016, primarily due to revenue from assets that were purchased during the third quarter of 2016 and in 2017, the effect of which was partially offset by the loss of revenue from assets that were on lease during 2016, but off lease in 2017 and by the loss of revenue from an aircraft that was involved in an accident in April 2016 and was declared a total loss.

Average portfolio utilization was approximately 93% during both 2017 and 2016.

Maintenance reserves that are retained by the Company at lease end are recorded as revenue at that time. During 2017, the Company recorded maintenance reserves revenue of \$3.9 million related to retained maintenance reserves at the time of lease termination for seven aircraft. The Company did not record any maintenance reserves revenue in 2016.

Finance lease revenue increased 81% to \$1.6 million in 2017 from \$0.9 million in 2016 as a result of (i) the sale of three aircraft pursuant to sales-type finance leases in late 2016 and early 2017 and (ii) the acquisition and lease of three aircraft pursuant to direct financing leases in early 2017.

As a result of asset acquisitions and sales during 2016 and 2017, as well as changes in estimated residual values from year-to-year, depreciation increased by 32% in 2017 as compared to 2016.

The average net book value of assets held for lease during 2017 and 2016 was approximately \$196.5 million and \$163.4 million, respectively. Management fees, which are based on the net book value of the Company's aircraft and engines as well as finance lease receivable balances, were 17% higher in 2017 as compared to 2016.

As a result of both a higher average debt balance and a higher average interest rate on the Company's Credit Facility, reflecting increases in LIBOR rates, in 2017, the Company's interest expense increased by 45% to \$7.8 million from \$5.3 million in 2016.

The Company's professional fees, general and administrative and other expenses increased by 16% to \$1.9 million in 2017 from \$1.7 million in 2016. The increase was primarily a result of \$619,400 of expenses incurred in 2017 related to the proposed acquisition of JHC by the Company, the total of which exceeded expenses incurred in 2016 in connection with the return of three aircraft by a lessee.

The Company's maintenance expense decreased by 11% to \$2.9 million in 2017 from \$3.3 million in 2016, as a result of a decrease in maintenance performed by the Company on off-lease aircraft to prepare them for sale or re-lease.

During 2017, the Company recorded impairment charges of (i) \$0.7 million for two turboprop aircraft, based on their appraised values, (ii) \$0.1 million for an asset that was written down to its net sales value and subsequently sold in 2017 and (iii) \$0.2 million for an asset that was written down to its net sales value and sold in early 2018. During 2016, the Company recorded impairment charges of (i) \$0.9 million for a spare engine, based on its appraised value, (ii) \$0.2 million on a second spare engine, based on its net sales value and (iii) \$0.1 million related to two of its four regional jet aircraft based their net sales value.

The Company did not incur bad debt expense in 2017. During 2016, the Company recorded bad debt expense of \$0.8 million related to an aircraft that was returned prior to lease end, for which the Company did not receive the operating lease revenue previously accrued.

In December 2017, the Act was enacted; a principal provision of the new law was a reduction in the U.S. federal corporate income tax rate from a maximum of 35% to 21% for years beginning in 2018, as well as a number of other provisions, including changes to net operating loss rules, repeal of the corporate alternative minimum tax and significant changes to U.S. corporate taxation of foreign subsidiaries and their accumulated, untaxed income. The most significant effect to the Company is expected to be the reduced corporate tax rate. Under U.S. accounting principles, a reporting entity's deferred tax assets and liabilities are determined by reference to the expected future tax rate applicable to when differences between the book carrying value and the adjusted tax basis of assets and liabilities are expected to be realized (or the value or cost of other recognized items, such as tax credits). As such, and given the net deferred tax liability position of the Company, the reduced future corporate rate resulted in a decrease in net tax liabilities, which is reflected as a decrease in tax expense in 2017 of approximately \$5.4 million and a net tax benefit, or increase to income, of \$4.0 million.

The Company recorded net income of \$7.4 million in 2017, compared to net income of \$1.2 million in 2016.

### *Liquidity and Capital Resources*

The Company is currently financing its assets primarily through debt financing and excess cash flows.

#### *(a) Credit Facility*

During July 2017, the Company's Credit Facility, as described in Note 6(a) to the Company's consolidated financial statements in Item 8 of this Annual Report on Form 10-K, was increased from \$150 million to \$170 million. In December 2017, the Credit Facility was amended to allow for the Company's proposed acquisition of JHC, discussed in Note 7 and below. Covenants regarding profitability, a debt to equity ratio and customer concentration were also modified.

The Company was in compliance with all covenants at December 31, 2017 and December 31, 2016. Among the more significant factors that could have an impact on the Company's future covenant compliance are (i) unanticipated decreases in the market value of the Company's assets, or in the rental rates deemed achievable for such assets that cause the Company to record an impairment charge against earnings, (ii) lessee non-compliance with lease obligations, (iii) inability to locate new lessees for returned equipment within a reasonable remarketing period, or at a rent level consistent with projected rates, (iv) an inability to locate and acquire a sufficient volume of additional assets at prices that will produce acceptable net returns, (v) increases in interest rates, or (vi) an inability to timely dispose of off-lease assets at prices commensurate with their market value.

The unused amount of the Credit Facility was \$43 million as of the date of this filing. The Company believes that available borrowings under the Credit Facility will be sufficient to meet its continuing obligations and, if the Credit Facility is expanded from its current amount of \$170 million to the maximum of \$180 million, to fund anticipated acquisitions. However, there can be no assurance that the entire unused amount of the Credit Facility will be available for acquisitions as a result of covenant restrictions or that the lenders under the Credit Facility will agree to expand the Credit Facility when requested by the Company.

As discussed above, in December 2017, the Company obtained the consent of the Credit Facility lenders to the Merger, and modifications to the Credit Facility for post-Merger periods in order to prevent certain expense items arising from the Merger from causing a default under the Credit Facility agreement covenants. The modifications impose a limit on the amount of settlement loss and merger costs that will be disregarded for covenant purposes, but the Company believes that these limits are sufficient to avoid causing a default under the loan agreement financial covenants.

Any default under the Credit Facility, if not cured in the time permitted under the facility or waived by the lenders, could result in the Company's inability to borrow any further amounts under the Credit Facility, the acceleration of the Company's obligation to repay amounts borrowed under the Credit Facility, or foreclosure upon any or all of the assets of the Company.

*(b) Special purpose financings*

In August 2016, using wholly-owned special purpose entities, the Company acquired two regional jet aircraft, using cash and third-party financing separate from its Credit Facility, as described in Note 6(b) to the Company's consolidated financial statements in Item 8 of this Annual Report on Form 10-K.

*(c) Cash flow*

The Company's primary sources of cash are payments due under the Company's operating and finance leases, maintenance reserves, which are billed monthly to lessees based on asset usage, and proceeds from the sale of aircraft and engines.

The Company's primary uses of cash are for (i) purchase of assets, (ii) Credit Facility and special purpose financing interest and principal payments, (iii) maintenance expense and reimbursement to lessees from collected maintenance reserves, (iv) management fees, and (v) professional fees, including legal and accounting.

The Company's payments for maintenance consist of reimbursements to lessees for eligible maintenance costs under their leases and maintenance incurred directly by the Company for preparation of off-lease assets for re-lease to new customers or for sale. The timing and amount of such payments may vary widely between quarterly and annual periods, as the required maintenance events can vary greatly in magnitude and cost, and the performance of the required maintenance events by the lessee or the Company, as applicable, are not regularly scheduled calendar events and do not occur at uniform intervals throughout any calendar period. The Company's maintenance payments typically constitute a large portion of its cash needs, and the Company may from time to time borrow additional funds under the Credit Facility to provide funding for such payments.

Management fees paid by the Company are relatively predictable because they are based on the net asset value of the Company's portfolio and finance lease receivable balances. Because of this, the risk of increased costs for employee salaries and benefits, worldwide travel related to the management of the Company's aircraft portfolio, office rent, outside technical experts and other overhead expenses is entirely placed on JMC. If, pursuant to the Merger, the Company acquires JHC causing JMC to become an indirect, wholly-owned subsidiary of the Company, the Company will assume this risk of fluctuating costs.

The amount of interest paid by the Company depends primarily on the outstanding balance of its Credit Facility, which carries a floating interest rate as well as an interest rate margin, and is therefore also dependent on changes in prevailing interest rates. Interest related to the Company's special purpose financings is payable at a fixed rate.



Management believes that the Company will have adequate cash flow to meet its ongoing operational needs, including any required repayments under the Credit Facility, based upon its estimates of future revenues and expenditures, which include assumptions regarding (i) revenues for assets to be re-leased, (ii) cost and anticipated timing of maintenance to be performed, (iii) required debt payments, (iv) timely use of proceeds of unused debt capacity for additional acquisitions of income producing assets and (v) interest rates. Although the Company believes that the assumptions it has made in forecasting its cash flow are reasonable in light of experience, actual results could deviate from such assumptions. As discussed above, in *Liquidity and Capital Resources – (a) Credit Facility*, there are a number of factors that may cause actual results to deviate from such forecasts.

(i) *Operating activities*

The Company's cash flow from operations increased by \$3.2 million in 2017 compared to 2016. As discussed below, the increase in cash flow was primarily a result of increases in payments received for operating lease revenue and maintenance reserves and a decrease in payments for maintenance. This positive effect was partially offset by increases in payments for interest and management fees.

(A) Receipts for operating lease revenue

Rent receipts from lessees increased by \$2.7 million, to \$27.6 million in 2017 from \$24.9 million in 2016, primarily due to additional rent from assets purchased and leased to customers in late 2016 and during 2017.

As of the date of this filing, the Company is receiving no lease revenue for six aircraft held for lease that are off lease. The total book value of these assets is \$21.1 million, representing 11% of the Company's total assets held for lease.

(B) Receipts for maintenance reserves

Receipts for maintenance reserves from lessees increased by \$2.9 million, to \$7.7 million in 2017 from \$4.8 million in 2016, primarily as a result of additional assets purchased in the third quarter of 2016 and during 2017, for which the Company collected maintenance reserves in 2017.

(C) Payments for maintenance

Payments for maintenance decreased by \$1.6 million, to \$7.1 million in 2017 from \$8.7 million in 2016 as a result of lower maintenance expense in 2017 and a difference in the timing of payments for maintenance.

(C) Payments for interest

Payments for interest increased by \$2.1 million, to \$6.7 million in 2017 from \$4.6 million in 2016 as a result of a higher average debt balance and higher rates during the 2017 period, as well as fees for amendments to the Company's Credit Facility during 2017.

(D) Payments for management fees

Management fee payments, which are based on the net book value of assets, increased by \$1.9 million, to \$6.6 million in 2017 from \$4.7 million in 2016, as a result of aircraft acquisitions during 2016 and 2017, as well as a difference in the timing of management fee payments.

(ii) *Investing activities*

During 2017 and 2016, the Company received net cash of \$12.9 million and \$6.3 million, respectively, from the sale of assets. During 2016, the Company also received \$18.9 million of insurance proceeds related to the total loss of an aircraft during the period and for the 2015 damage to an aircraft.

During 2017, the Company used cash of \$32.1 million for acquisitions of aircraft subject to operating leases and \$7.6 million for acquisition of aircraft subject to direct financing leases. During 2016, the Company used cash of \$54.4 million for acquisition of aircraft subject to operating leases.

(iii) *Financing activities*

The Company borrowed an additional \$35.9 million and \$31.3 million under the Credit Facility during 2017 and 2016, respectively. In 2017 and 2016, the Company repaid \$12.0 million and \$31.6 million, respectively, of its total outstanding debt under the Credit Facility. Such repayments were funded by operating cash flow and the sale of assets and, in 2016, insurance proceeds. During 2017 and 2016, the Company paid \$1.2 million and \$0.1 million, respectively, of issuance and amendment fees.

During 2017 and 2016, the Company's special purpose entities repaid \$4.1 million and \$2.0 million, respectively, of special purpose entity financing principal. The special purpose entities borrowed \$19.6 million during 2016.

**Outlook**

The Company has identified three factors that may affect the Company's growth and operating results:

- The Company entered into an Agreement and Plan of Merger to acquire JHC on October 26, 2017. There are several conditions to the closing of the Merger between the Company and JHC, most of which are out of the control of the Company. On February 22, 2018, the State of California Department of Business Oversight ("DBO") held a hearing regarding the Merger pursuant to Section 25142 of the California Corporations Code, to determine whether the terms and conditions of the issuance of AeroCentury's shares of Common Stock in the Merger to JHC's shareholders are fair. Following the hearing, a permit was issued by the DBO, which will allow the issuance of the Company's common stock in the Merger transaction to be exempt from federal securities registration under Section 3(a)(10) of the Securities Act. The Company is currently in the process of soliciting the consent of JHC's shareholders to the Merger which is one of several conditions precedent to the closing of the Merger. The Merger is anticipated to be consummated early in the second quarter of 2018, but there can be no assurance that such closing will occur, or that it will occur in the anticipated time frame. The Company believes that the combination of the management function performed by JMC and the portfolio held by the Company will be accretive to the Company and will create shareholder value for the shareholders of the combined post-Merger company, but such accretion may not be realized until after transaction and integration costs in connection with the Merger have been incurred. The Company also believes that the elimination of the outside management company structure removes a key impediment to capital raising by the Company. The Company, however, will incur certain non-recurring Merger expenses in the periods leading up to the Merger, and immediately following, as well as having to record, for accounting purposes, a settlement loss at the time of consummation of the Merger, which could negatively affect the Company's results for those periods.
- Increased production of aircraft types in the Company's market niche has resulted in some manufacturers offering competitive pricing for new aircraft to regional aircraft customers. In addition, notwithstanding recent interest rate increases in the U.S., competition for assets in the Company's market niche of worldwide regional aircraft has continued to increase. Some of the Company's newer competitors are funded by investment banks and private equity firms seeking higher yields on investment assets than are currently available from traditional income investment types. The increased competition has resulted in higher acquisition prices for many of the aircraft types that the Company has targeted to buy and, at the same time, continues to put downward pressure on lease rates, resulting in lower margins and, therefore, fewer acceptable acquisition opportunities for the Company. The Company anticipates this trend will continue for the short- to medium-term, until yields on alternative investments return to a more normal historical range. The Company believes, however, that it is competitive because of JMC's expertise and operational efficiency in identifying and obtaining financing for the transaction types desired by regional air carriers.
- The Company has not identified re-lease or sale customers for six turboprop aircraft that are currently off lease. The Company is analyzing the amount and timing of maintenance required to remarket these assets, the amount of which may differ significantly if the assets are sold rather than re-leased. These aircraft are older types that are no longer in production, so it is not unusual that market demand for them is weak and, therefore, they may remain off lease for significant periods of time.

## ***Critical Accounting Policies, Judgments and Estimates***

The Company's discussion and analysis of its financial condition and results of operations are based upon the financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities at the date of the financial statements. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company's operating results and financial position could be materially affected. For a discussion of Critical Accounting Policies, Judgments and Estimates, refer to Note 1 to the Company's financial statements in Item 8 of this Annual Report on Form 10-K.

## ***Factors that May Affect Future Results***

*Noncompliance with Debt Financial Covenants.* The Company's use of debt as the primary form of acquisition financing subjects the Company to increased risks associated with leverage. In addition to payment obligations, the Company's debt agreements include financial covenants, including some requiring the Company to have positive earnings, meet minimum net worth standards and be in compliance with certain other financial ratios.

Although the Company believes it will continue to be in compliance with all of the covenants under its debt agreements, there can be no assurance of such compliance, and in the event of any non-compliance, the Company would need to seek further waivers or amendments of applicable covenants from its lenders if such compliance failure is not timely cured. Any default under a debt agreement, if not cured in the time permitted or waived by the respective lender, could result in the Company's inability to borrow under the Credit Facility, the acceleration of the Company's debt obligations, or the foreclosure upon any or all of the assets of the Company.

*Consummation of Merger May Subject the Company to Additional Risks.* In October 2017, the Company announced its agreement to acquire JHC, the parent of the Company's management company, JMC, by way of a reverse triangular merger. There can be no assurance that the Merger will be consummated as there are numerous closing conditions that must be satisfied, some of which are out of the control of the Company. The entry into the Agreement and Plan of Merger subjects the Company to additional risks, including the following:

- *Merger Expenses.* In addition to legal, accounting and financial advisory fees incurred prior to the execution of the Agreement and Plan of Merger, in order to consummate the Merger, the Company will need to incur significant additional expenses, including legal and third party consulting fees, which will be payable whether or not the Merger eventually occurs.
- *Settlement Loss Effect on Covenant Compliance.* The Company believes that if the acquisition by merger of JHC is consummated, it will record a settlement loss related to its existing obligations under the management agreement with JMC on the closing date of the Merger in an amount equal to a substantial portion of the purchase consideration to be paid in the Merger. The amount of the loss cannot be ascertained exactly until the Merger closes, as it depends on several variables, including final adjustments to the agreed purchase price and the quoted market price of AeroCentury Common Stock on the Merger closing date. In December 2017, the Company obtained the consent of the Credit Facility lenders to the Merger, and modifications to the Credit Facility for post-Merger periods to prevent certain expense items arising from the Merger causing a default under the Credit Facility agreement covenants. The modifications impose a limit on the amount of settlement loss and merger costs that will be disregarded for covenant purposes, but the Company believes that they are sufficient to avoid these from causing a default under the Credit Facility financial covenants.
- *Assumption of Expenses Covered under Management Agreement.* Under the Management Agreement, the Company pays a management fee to JMC based upon the book value of the Company's aircraft assets, an acquisition fee for each asset purchased by the Company, and a remarketing/re-lease fee for each sale or re-lease transaction entered into with respect to the Company's aircraft. In return, JMC provides the Company with comprehensive management services, under which JMC has full responsibility for payment of all employee salaries and benefits, outside technical services, worldwide travel needed to promote the Company's business, office space, utilities, IT

and communications, furniture and fixtures, and other general administrative and overhead costs. Under the Management Agreement, if the fees collected are not enough to cover JMC's expenses in managing the Company's portfolio, such losses are borne entirely by JMC. If the Merger is consummated, then the obligation to pay JMC management fees will cease, but the costs previously borne by JMC in managing the Company's assets will be borne by the Company and will not be limited, as was the case when the Management Agreement was in place.

- *Assumption of JHC Liabilities.* By acquiring JHC in a reverse triangular merger, JHC will become a wholly-owned subsidiary of the Company. To the extent that JHC or any of its subsidiaries have liabilities, these will become liabilities of the Company on a consolidated basis. While the Merger Agreement provides for limited indemnification by JHC shareholders for certain liabilities of JHC or its subsidiaries that arise from pre-Merger occurrences, and the Company has performed due diligence reviews of the liabilities of JHC and its subsidiaries, the indemnification is limited to the consideration paid by the Company to JHC.

*Availability of Financing.* The Company's continued growth will depend on its ability to continue to obtain capital, either through debt or equity financings. One of the current primary limiters on the Company's ability to draw under the current credit facility is the covenant limitation on the Company's maximum debt to equity ratio. Under the current terms, even if the credit facility limit were increased, in order to utilize the higher limit, the Company would need to source additional equity capital in order to remain in compliance with the debt to equity ratio covenant to utilize the higher limit. Thus, the Company would need to raise additional equity capital to accompany any increase in the current credit facility, or, in the alternative, would need to refinance its credit facility debt with a new lender with more favorable financial covenants not limited by the Company's current equity capitalization. There can be no assurance that the Company will obtain such additional equity capital in the future or that it will be successful in obtaining more favorable credit facility financing.

*Credit Facility Debt Limitations.* The amount available to be borrowed under the Credit Facility is limited by asset-specific advance rates. Lease arrearages or off-lease periods for a particular asset that is collateral under the Credit Facility may reduce the loan advance rate permitted with respect to that asset and, therefore, reduce the permitted borrowing under the facility. Amounts subject to payment deferral agreements also reduce the amount of permitted borrowing. The Company believes it will have sufficient cash funds to make any required principal repayment that arises due to any such borrowing limitations.

*Ownership Risks.* The Company's leases typically are for a period shorter than the entire, anticipated, remaining useful life of the leased assets. As a result, the Company's recovery of its investment and realization of its expected yield in such a leased asset is dependent upon the Company's ability to profitably re-lease or sell the asset following the expiration of the lease. This ability is affected by worldwide economic conditions, general aircraft market conditions, regulatory changes, changes in the supply or cost of aircraft equipment, and technological developments that may cause the asset to become obsolete. If the Company is unable to remarket its assets on favorable terms when the leases for such assets expire, the Company's financial condition, cash flow, ability to service debt, and results of operations could be adversely affected.

The Company typically acquires used aircraft equipment. The market for used aircraft equipment has been cyclical, and generally reflects economic conditions and the strength of the travel and transportation industry. The demand for and value of many types of used aircraft in the recent past has been depressed by such factors as airline financial difficulties, airline consolidations, the number of new aircraft on order, an excess supply of newly manufactured aircraft or used aircraft coming off lease, as well as introduction of new aircraft models and types that may be more technologically advanced, more fuel efficient and/or less costly to maintain and operate. Values may also increase or decrease for certain aircraft types that become more or less desirable based on market conditions and changing airline capacity. Because the Company's ability to borrow under its credit facility is subject to a covenant setting forth a minimum ratio of the outstanding debt under the facility to the appraised value of the collateral base of aircraft assets securing the credit facility, a significant drop in the appraised market value of the portfolio could require the Company to make a substantial prepayment of outstanding principal under the credit facility in order to avoid a default under the credit facility.

In addition, a successful investment in an asset subject to a lease depends in part upon having the asset returned by the lessee in the condition as required under the lease. Each lease typically obligates a customer to return an asset to the Company in a specified condition, generally in equal or better condition than at delivery to the lessee. The Company strives to ensure this result through onsite management during the return process. However, if the lessee were to become insolvent during the term of its lease and the Company had to repossess the asset, it is unlikely that the lessee would have the financial ability to meet these return obligations. In addition, if the lessee filed for bankruptcy and rejected the aircraft lease, the lessee would be required to return the aircraft but would be relieved from further lease obligations, including return conditions specified in the lease. In either case, it is likely that the Company would be required to expend funds in excess of any maintenance reserves collected to return the asset to a remarketable condition.

Several of the Company's leases with financially strong lessees do not require payment of monthly maintenance reserves, which serve as the lessee's advance payment for its future repair and maintenance obligations. If repossession due to lessee default or bankruptcy occurred under such a lease, the Company would be left with the costs of unperformed repair and maintenance under the applicable lease and the Company would likely incur an unanticipated expense in order to re-lease or sell the asset.

Furthermore, the occurrence of unexpected adverse changes that impact the Company's estimates of expected cash flows generated from an asset could result in an asset impairment charge against the Company's earnings. The Company periodically reviews long-term assets for impairment, particularly when events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment charge is recorded when the carrying amount of an asset is estimated to be not recoverable and exceeds its fair value. The Company recorded impairment charges for some of its aircraft in 2016 and 2017, and may be required to record asset impairment charges in the future as a result of a prolonged weak economic environment, challenging market conditions in the airline industry, events related to particular lessees, assets or asset types or other factors affecting the value of aircraft or engines.

*Lessee Credit Risk.* The Company carefully evaluates the credit risk of each customer and attempts to obtain a third party guaranty, letters of credit or other credit enhancements, if it deems them necessary, in addition to customary security deposits. There can be no assurance, however, that such enhancements will be available, or that, if obtained, will fully protect the Company from losses resulting from a lessee default or bankruptcy.

If a lessee that is a certified U.S. airline were in default under a lease and sought protection under Chapter 11 of the United States Bankruptcy Code, Section 1110 of the Bankruptcy Code would automatically prevent the Company from exercising any remedies against such lessee for a period of 60 days. After the 60-day period had passed, the lessee would have to agree to perform the lease obligations and cure any defaults, or the Company would have the right to repossess the equipment. However, this procedure under the Bankruptcy Code has been subject to significant litigation, and it is possible that the Company's enforcement rights would be further adversely affected by a bankruptcy filing by a defaulting lessee.

Lessees located in low-growth or no-growth areas of the world carry heightened risk of an unanticipated lessee default. The Company has had customers that have experienced significant financial difficulties, become insolvent, or have entered bankruptcy proceedings. An insolvency or bankruptcy of a customer usually results in a total loss of the receivables from that customer, as well as the Company incurring additional costs in order to repossess and, in some cases, repair the aircraft. The Company closely monitors the performance of all of its lessees and its risk exposure to any lessee that may be facing financial difficulties, in order to guide decisions with respect to such lessee that would mitigate losses in the event the lessee is unable to meet or rejects its lease obligations. There can be no assurance that additional customers will not become insolvent or file for bankruptcy or that the Company will be able to mitigate any of the resultant losses.

It is possible that the Company may enter into deferral agreements for overdue lessee obligations. When a customer requests a deferral of lease obligations, the Company evaluates the lessee's financial plan, the likelihood that the lessee can remain a viable carrier, and whether the deferral will be repaid according to the agreed schedule. The Company may elect to record the deferred rent and reserves payments from the lessee on a cash basis, which could have a material effect on the Company's financial results in the applicable periods. Deferral agreements with lessees also reduce the Company's borrowing capacity under its Credit Facility.



*Concentration of Lessees and Aircraft Type.* For the month ended February 28, 2018, the Company's four largest customers accounted for a total of approximately 84% of the Company's monthly operating lease revenue. A lease default by or collection problem with one or a combination of any of these significant customers could have a disproportionate negative impact on the Company's financial results and borrowing base under the Credit Facility, and, therefore, the Company's operating results are especially sensitive to any negative developments with respect to these customers in terms of lease compliance or collection. In addition, if the Company's revenues become overly concentrated in a small number of lessees, the Company could fail to comply with certain financial covenants in its Credit Facility related to customer concentration. In the event of any non-compliance that is not cured in the time permitted under the Credit Facility, the Company would need to seek waivers or amendment of the applicable covenants if such compliance failure is not timely cured. Any default under the Credit Facility, if not cured in the time permitted under the Credit Facility or waived by the lenders, could result in foreclosure upon any or all of the assets of the Company.

The Company's aircraft portfolio is currently focused on a small number of aircraft types and models compared to the variety of aircraft used in the commercial air carrier market. A change in the desirability and availability of any of the particular types and models of aircraft owned by the Company could affect valuations and future rental revenues of such aircraft, and would have a disproportionately significant impact on the Company's portfolio value. Such aircraft type concentration would diminish if the Company acquires assets of other types. Conversely, acquisition of additional aircraft of types currently owned by the Company will increase the Company's risks related to its concentration of those aircraft types.

*Competition.* The aircraft leasing industry is highly competitive. The Company competes with aircraft manufacturers, distributors, airlines and aircraft operators, equipment managers, leasing companies, equipment leasing programs, financial institutions and other parties engaged in leasing, managing or remarketing aircraft, many of which have significantly greater financial resources. Competition in the Company's market niche of regional aircraft, however, has increased significantly recently as a result of new entrants to the acquisition and leasing market and consolidation of certain competitors. As competition increases, it has and will likely continue to create upward pressure on acquisition prices for many of the aircraft types that the Company has targeted to buy and, at the same time, create downward pressure on lease rates, resulting in lower margins for the Company and, therefore, fewer acceptable acquisition opportunities for the Company.

*Risks Related to Regional Air Carriers.* The Company's continued focus on its customer base of regional air carriers subjects the Company to additional risks. Many regional airlines rely heavily or even exclusively on a code-share or other contractual relationship with a major carrier for revenue, and can face financial difficulty or failure if the major carrier terminates the relationship or if the major carrier files for bankruptcy or becomes insolvent. Some regional carriers may depend on contractual arrangements with industrial customers such as mining or oil companies, or franchises from governmental agencies that provide subsidies for operating essential air routes, which may be subject to termination or cancellation on short notice. Furthermore, many lessees in the regional air carrier market are start-up, low-capital, and/or low-margin operators. A current concern for regional air carriers is the supply of qualified pilots. Due to recently imposed FAA regulations requiring a higher minimum number of hours to qualify as a commercial passenger pilot, many regional airlines have had difficulty meeting their business plans for expansion. This could in turn affect demand for aircraft and the Company's business.

*General Economic Conditions and Lowered Demand for Travel.* While the United States economy has seen substantial improvement since its most recent global recession, not all global regions are experiencing growth, and some remain in recession. The Company does not anticipate any worsening of the financial condition of its overall customer base, but believes that there may be further shakeouts of weaker carriers in economically troubled regions.

A growing concern arises from the fact that much of the recent growth in demand for regional aircraft in developing countries has arisen from mining or other resource extraction operations by Chinese enterprises in these countries. A future, sustained major downturn in the Chinese domestic economy that reduces demand for imported raw materials could have a significant negative impact on the demand for business and regional aircraft in these developing countries, including in some of the markets in which the Company does, or seeks to do, business.

Furthermore, any further upheavals due to instability in Europe due to newly imposed U.S. sanctions against Russia, and the Russian and European reaction to such sanctions could have a negative impact on intra-European carriers with which the Company does business. Also, Brexit and any further departures from the European Union (“EU”) could threaten “open-sky” policies under which EU based carriers operate freely within the EU. Losing open-sky flight rights could have a significant negative impact on the health of the Company’s European lessees and, as a result, the financial performance and condition of the Company.

If international conflicts erupt into military hostilities, heightened visa requirements make international travel more difficult, or terrorist attacks involving aircraft or airports occur, or a major flu outbreak occurs, passengers may avoid air travel altogether, and global air travel worldwide could be significantly affected. This would have an adverse impact on many of the Company’s customers.

Airline reductions in capacity in response to lower passenger loads can result in reduced demand for aircraft and aircraft engines and a corresponding decrease in market lease rental rates and aircraft values. This reduced market value could affect the Company’s results if the market value of an asset or assets in the Company’s portfolio falls below carrying value, and the Company determines that a write-down of the value on its balance sheet is appropriate. Furthermore, if older, expiring leases are replaced with leases at decreased lease rates, the lease revenue from the Company’s existing portfolio is likely to decline, with the magnitude of the decline dependent on the length of the downturn and the depth of the decline in market rents.

Economic downturns can affect certain regions of the world more than others. As the Company’s portfolio is not entirely globally diversified, a localized downturn in one of the key regions in which the Company leases assets could have a significant adverse impact on the Company. The Company’s significant sources of operating lease revenue by region are summarized in Item 7 - *Fleet Summary*, above.

*International Risks.* The Company leases assets in overseas markets. Leases with foreign lessees, however, may present different risks than those with domestic lessees. Most of the Company’s expected growth is outside of North America.

A lease with a foreign lessee is subject to risks related to the economy of the country or region in which such lessee is located, which may be weaker than the U.S. economy. An economic downturn in a particular country or region may impact a foreign lessee’s ability to make lease payments, even if the U.S. and other foreign economies remain stable.

Foreign lessees are subject to risks related to currency conversion fluctuations. Although the Company’s current leases are all payable in U.S. dollars, the Company may agree in the future to leases that permit payment in foreign currency, which would subject such lease revenue to monetary risk due to currency fluctuations.

Even with U.S. dollar-denominated lease payment provisions, the Company could still be affected by a devaluation of the lessee’s local currency and a stronger U.S. dollar that would make it more difficult for a lessee to meet its U.S. dollar-denominated payments, increasing the risk of default of that lessee, particularly if its revenue is primarily derived in the local currency.

Foreign lessees that operate internationally may also face restrictions on repatriating foreign revenue to their home country. This could create a cash flow crisis for an otherwise profitable carrier, affecting its ability to meet its lease obligations. Foreign lessees may also face restrictions on payment of obligations to foreign vendors, including the Company, which may affect their ability to timely meet lease obligations to the Company.

Foreign lessees are not subject to U.S. bankruptcy laws, although there may be debtor protection similar to U.S. bankruptcy laws available in some jurisdictions. Certain countries do not have a central registration or recording system which can be used to locally record the Company’s interest in equipment and related leases. This could make it more difficult for the Company to recover an aircraft in the event of a default by a foreign lessee. In any event, collection and enforcement may be more difficult and complicated in foreign countries.

Finally, ownership of a leased asset operating in a foreign country and/or by a foreign carrier may subject the Company to additional tax liabilities that are not present with aircraft operated in the United States. Depending on the jurisdiction, laws governing such tax liabilities may be complex, not well formed or not uniformly enforced. In such jurisdictions,

the Company may decide to take an uncertain tax position based on the best advice of the local tax experts it engages, which position may be challenged by the taxing authority. If the taxing authority later assesses a liability, the Company may be required to pay penalties and interest on the assessed amount, which penalties and interest would not give rise to a corresponding foreign tax credit on the Company's U.S. tax return.

*Interest Rate Risk.* The Credit Facility carries a floating interest rate based upon short-term interest rate indices. Lease rates typically, but not always, move over time with interest rates, but market demand and numerous other asset-specific factors also affect lease rates. Because the Company's typical lease rates are fixed at lease origination, interest rate changes during the lease term have no effect on existing lease rental payments. Therefore, if interest rates rise significantly and there is relatively little lease origination by the Company following such rate increases, the Company could experience decreased net income as additional interest expense outpaces revenue growth. Further, even if significant lease origination occurs following such rate increases, other contemporaneous aircraft market forces may result in lower or flat rental rates, thereby decreasing net income.

*Investment in New Aircraft Types.* The Company intends to continue to focus solely on regional aircraft. Although the Company invested in a limited number of turboprop aircraft types in the past, the Company has also acquired several regional jet aircraft types, which now comprise a larger percentage of the Company's portfolio based on number of aircraft and net book value. The Company may continue to seek acquisition opportunities for new types and models of aircraft used in the Company's targeted customer base of regional air carriers. Acquisition of aircraft types not previously acquired by the Company entails greater ownership risk due to the Company's lack of experience managing those assets. The Company believes, however, that its overall industry expertise may permit the Company to effectively manage such new aircraft types. Further, the broadening of the asset types in the aircraft portfolio may have a benefit of diversifying the Company's portfolio (see "Factors That May Affect Future Results – Concentration of Lessees and Aircraft Type," above).

*Reliance on JMC.* All management of the Company is currently performed by JMC under a Management Agreement between the Company and JMC that expires in August of 2025 and provides for an asset-based management fee. JMC is not a fiduciary of the Company or its stockholders. The Company's board of directors (the "Board") has ultimate control and supervisory responsibility over all aspects of the Company and owes fiduciary duties to the Company and its stockholders. The Board has no control over the internal operations of JMC, but the Board does have the ability and responsibility to manage the Company's relationship with JMC and the performance of JMC's obligations to the Company under the Management Agreement, as it would have for any third-party service provider to the Company. While JMC may not owe any fiduciary duties to the Company by virtue of the Management Agreement, all of the officers of JMC are also officers of the Company, and, in that capacity, owe fiduciary duties to the Company and its stockholders. In addition, an officer of the Company holds significant ownership positions in the Company and JHC, the parent company of JMC, and JHC is the Company's largest shareholder. Therefore, the economic interests of the Company should be aligned with the interests of JHC and JMC, and JMC should have substantial incentive to make financial decisions as the management company for the Company that are in the best interests of the Company.

The Management Agreement may be terminated if JMC defaults on its obligations to the Company. However, the agreement provides for liquidated damages in the event of its wrongful termination by the Company. A director of the Company is also a director of JMC and, as discussed above, the officers of the Company are also officers of JMC, and one such officer holds significant ownership positions in both the Company and JHC, the holding company for JMC. Consequently, the director and officers of JMC may have a conflict of interest in the event of a dispute between the Company and JMC. Although the Company has taken steps to prevent conflicts of interest arising from such dual roles, such conflicts may still occur.

There can be no assurance that the proposed Merger with JHC, the parent of JMC, will be consummated. If the Merger is consummated, the Company would have control over JMC's operations and it is expected that the foregoing risks would be largely mitigated. However, operating costs previously borne by JMC in managing the Company's assets would be borne by the Company, and there can be no assurance that such costs will be less than the fees previously paid to JMC.

*Management Fee Structure.* All decisions regarding acquisitions and disposal of aircraft from the Company's portfolio are currently made by JMC. JMC is paid a management fee based on the net asset value of the Company's portfolio. It may also receive a one-time asset acquisition fee upon purchase of an asset by the Company, and a one-time remarketing

fee in connection with the sale or re-lease of an asset. Optimization of the results of the Company depends on timing of the acquisition, lease yield on the acquired assets, and re-lease or sale of its portfolio assets. Under the current management fee structure, a larger volume of acquisitions generates acquisition fees and also increases the periodic management fee by increasing the size of the aircraft portfolio. Since the Company's current business strategy involves continued growth of its portfolio, with the intention to buy and hold assets until the appropriate time to sell them, a compensation structure that results in greater compensation with an increased portfolio size is consistent with that strategy. The compensation structure does, nonetheless, create a situation where a decision by JMC for the Company to forego an asset transaction deemed to be an unacceptable business risk due to the lessee or the aircraft type is in conflict with JMC's own short-term pecuniary interest. As a result, the compensation structure could act to incent greater risk-taking by JMC in asset acquisition decision-making. However, because JMC's sole business and source of revenue arises from and is expected to continue arising from acting as the management company for the Company, the long-term financial health and viability of the Company are important to JMC's own long-term health and viability. Therefore, in assessing risk-taking in the Company's acquisition transactions, JMC's and the Company's motivations are closely aligned, as JMC is incented to make asset acquisitions that are expected to contribute to the long-term viability of the Company. In addition, the Company has established objective target guidelines for yields on acquired assets and the Company's Board, including a majority of the outside independent directors, must approve any acquisition that involves a new asset type. While the Company currently believes the foregoing are effective mitigating factors against undue compensation-incented risk-taking by JMC, there can be no assurance that such mechanisms can entirely and effectively eliminate such risk.

If the Merger is consummated, the management fee would be internalized and it is expected that the foregoing risks would be largely mitigated.

*Government Regulation.* There are a number of areas in which government regulation may result in costs to the Company. These include aircraft registration safety requirements, required equipment modifications, maximum aircraft age, and aircraft noise requirements. Although it is contemplated that the burden and cost of complying with such requirements will fall primarily upon lessees, there can be no assurance that the cost will not fall on the Company. Furthermore, future government regulations could cause the value of any non-complying equipment owned by the Company to decline substantially.

*Casualties, Insurance Coverage.* The Company, as an owner of transportation equipment, may be named in a suit claiming damages for injuries or damage to property caused by its assets. As a triple-net lessor, the Company is generally protected against such claims, since the lessee would be responsible for, insure against and indemnify the Company for such claims. A "triple net lease" is a lease under which, in addition to monthly rental payments, the lessee is generally responsible for the taxes, insurance and maintenance and repair of the aircraft arising from the use and operation of the aircraft during the term of the lease. Although the United States Aviation Act may provide some protection with respect to the Company's aircraft assets, it is unclear to what extent such statutory protection would be available to the Company with respect to its assets that are operated in foreign countries where such provisions of the United States Aviation Act may not apply.

The Company's leases generally require a lessee to insure against likely risks of loss or damage to the leased asset, and liability to passengers and third parties pursuant to industry standard insurance policies and require lessees to provide insurance certificates documenting the policy periods and coverage amounts. The Company tracks receipt of the certificates and calendars their expiration dates. Prior to the expiration of an insurance certificate, if a replacement certificate has not been received, the Company reminds the lessee of its obligation to provide current insurance certificates to avoid a default under the lease.

Despite these requirements and procedures, there may be certain cases where the loss is not entirely covered by the lessee or its insurance. The possibility of such an event is remote, but any such uninsured loss with respect to the equipment or insured loss for which insurance proceeds are inadequate might result in a loss of invested capital in and any profits anticipated from, such equipment, as well as a potential claim directly against the Company.

*Compliance with Future Environmental Regulations.* Compliance with future environmental regulations may harm the Company's business. Many aspects of aircraft operations are subject to increasingly stringent environmental regulations, and growing concerns about climate change may result in the imposition by the U.S and foreign governments of additional regulation of carbon emissions, aimed at either requiring adoption of technology to reduce the amount of carbon

emissions or putting in place a fee or tax system on carbon emitters. It is likely that any such regulation will be directed at the Company's customers, as operators of aircraft, or at the Company, as owners of aircraft. Under the Company's triple-net lease arrangements, the Company would likely shift responsibility for compliance to its lessees, but there might be some costs of regulation that the Company could not shift and would itself have to bear. Although it is not expected that the costs of complying with current environmental regulations will have a material adverse effect on the Company's financial position, results of operations, or cash flows, no assurance can be given that the costs of complying with environmental regulations adopted in the future will not have such an effect.

*Cyber-Security Risks.* The Company believes that its main vulnerability to a cyber-attack would be interruption of the Company's email communications internally and with third parties, loss of customer and lease archives, and loss of document sharing between the Company's offices and remote workers. Such an attack could temporarily impede the efficiency of the Company's operations; however, the Company believes that sufficient replacement and backup mechanisms exist in the event of such an interruption such that there would not be a material adverse financial impact on the Company's business. A cyber-hacker could also gain access to and release proprietary information of the Company, its customers, suppliers and employees stored on the Company's data network. Such a breach could harm the Company's reputation and result in competitive disadvantages, litigation, lost revenues, additional costs, or liability to third parties. While the Company believes that it has sufficient cyber-security measures in place commensurate with the risks to the Company of a successful cyber-attack or breach of its data security, its resources and technical sophistication may not be adequate to prevent all types of cyber-attacks.

*Possible Volatility of Stock Price.* The market price of the Company's common stock is subject to fluctuations following developments relating to the Company's operating results, changes in general conditions in the economy, the financial markets, the airline industry, changes in accounting principles or tax laws applicable to the Company or its lessees, or other developments affecting the Company, its customers or its competitors, or arising from other investor sentiment unknown to the Company. Because the Company has a relatively small capitalization of approximately 1.4 million shares outstanding, there is a correspondingly limited amount of trading and float of the Company's shares. Consequently, the Company's stock price is more sensitive to a single large trade or a small number of simultaneous trades along the same trend than a company with larger capitalization and higher trading volume and float.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

This report does not include information described under Item 305 of Regulation S-K pursuant to the rules of the Securities and Exchange Commission that permit "smaller reporting companies" to omit such information.

## **Item 8. Financial Statements and Supplementary Data.**

### **(a) Financial Statements and Schedules**

- (1) Financial statements for the Company:
  - Report of Independent Registered Public Accounting Firm
  - Consolidated Balance Sheets as of December 31, 2017 and 2016
  - Consolidated Statements of Operations for the Years Ended December 31, 2017 and 2016
  - Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2017 and 2016
  - Consolidated Statements of Cash Flows for the Years Ended December 31, 2017 and 2016
  - Notes to Consolidated Financial Statements

- (2) Schedules:

All schedules have been omitted since the required information is presented in the consolidated financial statements or is not applicable.



## **Report of Independent Registered Public Accounting Firm**

Stockholders and Board of Directors  
AeroCentury Corp.  
Burlingame, California

### **Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of AeroCentury Corp. (the “Company”) as of December 31, 2017 and 2016 the related consolidated statements of operations, stockholders’ equity, and cash flows for each of the two years in the period ended December 31, 2017 and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the two years in the period ended December 31 2017, in conformity with accounting principles generally accepted in the United States of America.

### **Basis for Opinion**

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Company’s auditor since 2006.

San Francisco, California  
March 8, 2018

**Item 8. Financial Statements and Supplementary Data.**

**AeroCentury Corp.**  
**Consolidated Balance Sheets**

ASSETS	December 31, 2017	December 31, 2016
Assets:		
Cash and cash equivalents	\$ 8,657,800	\$ 2,194,400
Accounts receivable, including deferred rent of \$707,300 and \$604,800 at December 31, 2017 and December 31, 2016, respectively	3,825,100	4,046,100
Finance leases receivable	23,561,000	17,468,300
Aircraft and aircraft engines held for lease, net of accumulated depreciation of \$33,234,200 and \$32,639,600 at December 31, 2017 and December 31, 2016, respectively	195,098,200	192,799,800
Assets held for sale	4,966,500	1,998,100
Prepaid expenses and other	301,300	229,400
Total assets	<u>\$236,409,900</u>	<u>\$218,736,100</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable and accrued expenses	\$ 645,200	\$ 1,218,100
Notes payable and accrued interest, net of unamortized debt issuance costs of \$2,216,000 and \$1,999,900 at December 31, 2017 and December 31, 2016, respectively	145,598,200	125,837,900
Maintenance reserves	26,942,800	29,424,100
Accrued maintenance costs	1,275,300	965,000
Security deposits	3,147,900	3,933,200
Unearned revenues	2,447,500	1,903,900
Deferred income taxes	8,533,700	12,830,500
Income taxes payable	452,600	123,200
Total liabilities	<u>189,043,200</u>	<u>176,235,900</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 2,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, \$0.001 par value, 10,000,000 shares authorized, 1,629,999 shares issued, 1,416,699 and 1,566,699 outstanding at December 31, 2017 and December 31, 2016, respectively	1,600	1,600
Paid-in capital	14,780,100	14,780,100
Retained earnings	35,621,800	28,222,600
	<u>50,403,500</u>	<u>43,004,300</u>
Treasury stock at cost, 213,300 and 63,300 shares at December 31, 2017 and December 31, 2016	(3,036,800)	(504,100)
Total stockholders' equity	<u>47,366,700</u>	<u>42,500,200</u>
Total liabilities and stockholders' equity	<u>\$236,409,900</u>	<u>\$218,736,100</u>

The accompanying notes are an integral part of these consolidated financial statements.

**AeroCentury Corp.**  
**Consolidated Statements of Operations**

	For the Years Ended December 31,	
	2017	2016
Revenues and other income:		
Operating lease revenue, net	\$29,002,700	\$24,464,500
Maintenance reserves revenue, net	3,886,900	-
Finance lease revenue	1,571,500	868,100
Net gain on disposal of assets	791,500	2,149,600
Net gain on sales-type finance leases	297,400	1,216,700
Other income	3,800	17,400
	35,553,800	28,716,300
Expenses:		
Depreciation	12,025,600	9,139,700
Interest	7,753,200	5,339,700
Management fees	6,109,200	5,216,400
Maintenance	2,924,300	3,285,700
Professional fees, general and administrative and other	1,945,100	1,667,600
Provision for impairment in value of aircraft	1,002,100	1,226,800
Bad debt expense	-	835,800
Insurance	271,300	309,200
Other taxes	90,300	(276,600)
	32,121,100	26,744,300
Income before income tax provision	3,432,700	1,972,000
Income tax (benefit)/provision	(3,966,500)	750,300
Net income	\$ 7,399,200	\$ 1,221,700
Earnings per share:		
Basic	\$ 5.10	\$ 0.78
Diluted	\$ 5.10	\$ 0.78
Weighted average shares used in earnings per share computations:		
Basic	1,449,576	1,566,699
Diluted	1,449,576	1,566,699

The accompanying notes are an integral part of these consolidated financial statements.

**AeroCentury Corp.**  
**Consolidated Statements of Stockholders' Equity**  
**For the Years Ended December 31, 2017 and 2016**

	Number of Common Stock Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings	Treasury Stock	Total
Balance, December 31, 2015	1,566,699	\$1,600	\$14,780,100	\$27,000,900	\$ (504,100)	\$ 41,278,500
Net income	-	-	-	1,221,700	-	1,221,700
Balance, December 31, 2016	1,566,699	1,600	14,780,100	28,222,600	(504,100)	42,500,200
Repurchase of shares	(150,000)	-	-	-	(2,532,700)	(2,532,700)
Net income	-	-	-	7,399,200		7,399,200
Balance, December 31, 2017	1,416,699	\$1,600	\$14,780,100	\$35,621,800	\$(3,036,800)	\$47,366,700

The accompanying notes are an integral part of these consolidated financial statements.

**AeroCentury Corp.**  
**Consolidated Statements of Cash Flows**

	For the Years Ended December 31,	
	2017	2016
Operating activities:		
Net income	\$ 7,399,200	\$ 1,221,700
Adjustments to reconcile net income to net cash provided by operating activities:		
Net gain on disposal of assets	(791,500)	(2,149,600)
Net gain on sales-type finance leases	(297,400)	(1,216,700)
Depreciation	12,025,600	9,139,700
Provision for impairment in value of aircraft	1,002,100	1,226,800
Non-cash interest	1,012,300	879,000
Deferred income taxes	(4,296,800)	626,300
Changes in operating assets and liabilities:		
Accounts receivable	1,000,700	400,100
Finance leases receivable	(510,700)	(668,200)
Prepaid expenses and other	(123,500)	(10,200)
Accounts payable and accrued expenses	(572,000)	(152,400)
Accrued interest on notes payable	188,100	(35,400)
Maintenance reserves and accrued costs	(2,171,000)	698,700
Security deposits	(232,300)	780,500
Unearned revenue	608,500	481,000
Income taxes payable	329,400	123,200
Net cash provided by operating activities	14,570,700	11,344,500
Investing activities:		
Proceeds from sale of aircraft and aircraft engines held for lease, net of re-sale fees	12,741,200	2,918,400
Proceeds from sale of assets held for sale, net of re-sale fees	193,000	3,422,800
Proceeds from insurance	-	18,886,700
Investment in direct financing leases	(7,614,200)	-
Purchases of aircraft and aircraft engines	(32,063,100)	(54,357,600)
Net cash used in investing activities	(26,743,100)	(29,129,700)
Financing activities:		
Issuance of notes payable – Credit Facility	35,900,000	31,300,000
Repayment of notes payable – Credit Facility	(12,000,000)	(31,600,000)
Debt issuance costs	(1,152,500)	(65,000)
Issuance of notes payable – special purpose financing	-	19,609,900
Repayment of notes payable – special purpose financing	(4,111,700)	(1,986,300)
Net cash provided by financing activities	18,635,800	17,258,600
Net increase/(decrease) in cash and cash equivalents	6,463,400	(526,600)
Cash and cash equivalents, beginning of year	2,194,400	2,721,000
Cash and cash equivalents, end of year	\$ 8,657,800	\$ 2,194,400

During the years ended December 31, 2017 and 2016, the Company paid interest totaling \$6,642,300 and \$4,581,400, respectively. The Company paid income taxes of \$800 during each of 2017 and 2016. During 2017, the Company repurchased 150,000 shares of common stock in exchange for an aircraft engine with a value of \$2,532,700.

The accompanying notes are an integral part of these consolidated financial statements.



**AeroCentury Corp.**  
**Notes to Consolidated Financial Statements**  
**Year Ended December 31, 2017**

**1. Organization and Summary of Significant Accounting Policies**

*(a) The Company and Basis of Presentation*

AeroCentury Corp., a Delaware corporation incorporated in 1997, typically acquires used regional aircraft and engines for lease to foreign and domestic regional carriers.

In August 2016, AeroCentury Corp. formed two wholly-owned subsidiaries, ACY 19002 Limited (“ACY 19002”) and ACY 19003 Limited (“ACY 19003”) for the purpose of acquiring aircraft using a combination of cash and financing (“SPE Financing”) separate from the parent’s credit facility. Financial information for AeroCentury Corp., ACY 19002 and ACY 19003 (collectively, the “Company”) is presented on a consolidated basis in accordance with accounting principles generally accepted in the United States of America (“GAAP”) based upon the continuation of the business as a going concern. All intercompany balances and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the current year’s presentation. These changes did not impact the previously reported revenue, net income, stockholders’ equity or cash flows.

*(b) Use of Estimates*

The Company’s consolidated financial statements have been prepared in accordance with GAAP. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable for making judgments that are not readily apparent from other sources.

The most significant estimates with regard to these consolidated financial statements are the residual values and useful lives of the Company’s long lived assets, the amount and timing of future cash flows associated with each asset that are used to evaluate whether assets are impaired, accrued maintenance costs, accounting for income taxes, and the amounts recorded as allowances for doubtful accounts.

*(c) Cash and cash equivalents*

The Company considers highly liquid investments readily convertible into known amounts of cash, with original maturities of 90 days or less from the date of acquisition, as cash equivalents.

*(d) Aircraft Capitalization and Depreciation*

The Company’s interests in aircraft and aircraft engines are recorded at cost, which includes acquisition costs. Since inception, the Company has typically purchased only used aircraft and aircraft engines. It is the Company’s policy to hold aircraft for approximately twelve years unless market conditions dictate otherwise. Therefore, depreciation of aircraft is initially computed using the straight-line method over the anticipated holding period to an estimated residual value based on appraisal. For an aircraft engine held for lease as a spare, the Company estimates the length of time that it will hold the aircraft engine based upon estimated usage, repair costs and other factors, and depreciates it to the appraised residual value over such period using the straight-line method.

The Company periodically reviews plans for lease or sale of its aircraft and aircraft engines and changes, as appropriate, the remaining expected holding period for such assets. Estimated residual values are reviewed and adjusted periodically, based upon updated estimates obtained from an independent appraiser. Decreases in the fair value of aircraft could affect not only the current value, discussed below, but also the estimated residual value.

Assets that are held for sale are not subject to depreciation and are separately classified on the balance sheet. Such assets are carried at the lower of their carrying value or estimated fair values, less costs to sell.

(e) *Fair Value Measurements*

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs, to the extent possible. The fair value hierarchy under GAAP is based on three levels of inputs.

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

The carrying amount of the Company's money market funds included in cash and cash equivalents was \$6,151,900 and \$1,348,100 at December 31, 2017 and December 31, 2016, respectively. The fair value of the Company's money market funds is categorized as Level 1 under the GAAP fair value hierarchy.

As of December 31, 2017 and December 31, 2016, there were no liabilities that were required to be measured and recorded at fair value on a recurring basis.

Assets Measured and Recorded at Fair Value on a Nonrecurring Basis

The Company determines fair value of long-lived assets held and used, such as aircraft and aircraft engines held for lease and assets held for sale, by reference to independent appraisals, quoted market prices (e.g., offers to purchase) and other factors. With respect to aircraft assets not on lease, the appraised value the Company uses is the average of current value appraisals from two appraisers, based on their understanding of the market for such aircraft and assuming an open and unrestricted market on an arm's length basis, and given an adequate amount of time for effective exposure to buyers. For assets subject to lease, the Company uses the average of two appraisals calculated on an "encumbered" basis that takes into consideration the rental stream and future value at lease end based on each appraiser's estimate as adjusted for actual return conditions, using an appropriate discount rate. An impairment charge is recorded when the Company believes that the carrying value of an asset will not be recovered through future net cash flows and that the asset's carrying value exceeds its fair value.

(a) Assets held for lease

During 2017 and 2016, the Company recorded impairment charges of \$1,002,100 and \$905,600, respectively, on its assets held for lease.

(b) Assets held for sale

The Company recorded no impairment charges on its aircraft held for sale during 2017. During 2016, the Company recorded impairment charges of \$321,200 on three assets prior to their sale during the year.

## Fair Value of Other Financial Instruments

The Company's financial instruments, other than cash and cash equivalents, consist principally of finance leases receivable, amounts borrowed under its credit facility (the "Credit Facility") and notes payable under special purpose financing. The fair value of accounts receivable, finance leases receivable, accounts payable and the Company's maintenance reserves and accrued maintenance costs approximates the carrying value of these financial instruments.

Borrowings under the Company's Credit Facility bear floating rates of interest that reset periodically to a market benchmark rate plus a credit margin. The Company believes that the effective interest rate under the Credit Facility approximates current market rates for such indebtedness at the balance sheet date, and therefore that the outstanding principal and accrued interest of \$134,278,900 and \$110,183,600 at December 31, 2017 and December 31, 2016, respectively, approximate their fair values on such dates. The fair value of the Company's outstanding balance of its Credit Facility would be categorized as Level 3 under the GAAP fair value hierarchy.

The amounts payable under the Company's SPE Financing are payable through the fourth quarter of 2020 and bear a fixed rate of interest, as described in Note 6(b) to the consolidated financial statements. The Company believes that the effective interest rate under the SPE Financing approximates current market rates for such indebtedness at the balance sheet date, and therefore that the outstanding principal and accrued interest of \$13,535,300 and \$17,654,200 approximate their fair values at December 31, 2017 and December 31, 2016, respectively. Such fair value would be categorized as Level 3 under the GAAP fair value hierarchy.

### *(f) Impairment of Long-lived Assets*

The Company reviews assets for impairment when there has been an event or a change in circumstances indicating that the carrying amount of a long-lived asset may not be recoverable. In addition, the Company routinely reviews all long-lived assets for impairment semi-annually. Recoverability of an asset is measured by comparison of its carrying amount to the future estimated undiscounted cash flows (without interest charges) that the asset is expected to generate. Estimates are based on currently available market data and independent appraisals and are subject to fluctuation from time to time. If these estimated future cash flows are less than the carrying value of an asset at the time of evaluation, any impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Fair value is determined by reference to independent appraisals and other factors considered relevant by management. Significant management judgment is required in the forecasting of future operating results that are used in the preparation of estimated future undiscounted cash flows and, if different conditions prevail in the future, material write-downs may occur. As discussed in *(e) Fair Value Measurements* above, the Company recorded impairment provisions totaling \$1,002,100 and \$1,226,800 in 2017 and 2016, respectively.

### *(g) Deferred Financing Costs and Commitment Fees*

Costs incurred in connection with debt financing are deferred and amortized over the term of the debt using the effective interest method or, in certain instances where the differences are not material, using the straight-line method. Costs incurred in connection with the Company's Credit Facility are deferred and amortized using the straight-line method. Commitment fees for unused funds are expensed as incurred.

### *(h) Security deposits*

The Company's leases are typically structured so that if any event of default occurs under a lease, the Company may apply all or a portion of the lessee's security deposit to cure such default. If such application of the security deposit is made, the lessee typically is required to replenish and maintain the full amount of the deposit during the remaining lease term. All of the security deposits received by the Company are refundable to the lessee at the end of the lease upon satisfaction of all lease terms.

### *(i) Taxes*

As part of the process of preparing the Company's consolidated financial statements, management estimates income taxes in each of the jurisdictions in which the Company operates. This process involves estimating the Company's current tax exposure under the most recent tax laws and assessing temporary differences resulting from differing treatment

of items for tax and GAAP purposes. These differences result in deferred tax assets and liabilities, which are included in the balance sheet. Management also assesses the likelihood that the Company's deferred tax assets will be recovered from future taxable income, and, to the extent management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized, the Company establishes a valuation allowance. To the extent the Company establishes a valuation allowance or changes the allowance in a period, the Company reflects the corresponding increase or decrease within the tax provision in the statement of operations. Significant management judgment is required in determining the Company's future taxable income for purposes of assessing the Company's ability to realize any benefit from its deferred taxes.

The Company accrues non-income based sales, use, value added and franchise taxes as other tax expense in the statements of operations.

*(j) Revenue Recognition, Accounts Receivable and Allowance for Doubtful Accounts*

Revenue from leasing of aircraft assets pursuant to operating leases is recognized on a straight-line basis over the terms of the applicable lease agreements. Deferred payments are recorded as accrued rent when the cash rent received is lower than the straight-line revenue recognized. Such receivables decrease over the term of the applicable leases. Interest income is recognized on finance leases based on the interest rate implicit in the lease and the outstanding balance of the lease receivable. Maintenance reserves retained by the Company at lease-end are recognized as maintenance reserves revenue.

In instances where collectability is not reasonably assured, the Company recognizes revenue as cash payments are received. The Company estimates and charges to income a provision for bad debts based on its experience with each specific customer, the amount and length of payment arrearages, and its analysis of the lessee's overall financial condition. If the financial condition of any of the Company's customers deteriorates, it could result in actual losses exceeding any estimated allowances.

The Company had no allowance for doubtful accounts at December 31, 2017 and 2016.

*(k) Comprehensive Income*

The Company does not have any comprehensive income other than the revenue and expense items included in the statements of operations. As a result, comprehensive income equals net income for the years ended December 31, 2017 and 2016.

*(l) Finance Leases*

As of December 31, 2017, the Company had six aircraft subject to sales-type finance leases and three aircraft subject to direct financing leases. All nine leases contain lessee bargain purchase options at prices substantially below the subject assets' estimated residual values at the exercise date for the options. Consequently, the Company has classified each of these nine leases as finance leases for financial accounting purposes. For such finance leases, the Company reports the discounted present value of (i) future minimum lease payments (including the bargain purchase option) and (ii) any residual value not subject to a bargain purchase option as a finance lease receivable on its balance sheet and accrues interest on the balance of the finance lease receivable based on the interest rate inherent in the applicable lease over the term of the lease. For each of the six sales-type finance leases, the Company recognized as a gain or loss the amount equal to (i) the net investment in the sales-type finance lease plus any initial direct costs and lease incentives less (ii) the net book value of the subject aircraft at inception of the applicable lease.

The Company recognized revenue from interest earned on finance leases in the amount of \$1,571,500 and \$868,100 in 2017 and 2016, respectively.

*(m) Maintenance Reserves and Accrued Maintenance Costs*

Maintenance costs under the Company's triple net leases are generally the responsibility of the lessees. Some of the Company's leases require payment of maintenance reserves, which are based upon lessee-reported usage and billed monthly, and are intended to accumulate and be applied by the Company toward reimbursement of most or all of the

cost of the lessees' performance of certain maintenance obligations under the leases. Such reimbursements reduce the associated maintenance reserve liability.

Maintenance reserves are characterized as either refundable or non-refundable depending on their disposition at lease-end. The Company retains non-refundable maintenance reserves at lease-end, even if the lessee has met all of its obligations under the lease, including any return conditions applicable to the leased asset, while refundable reserves are returned to the lessee under such circumstances. Any reserves retained by the Company at lease end are recorded as revenue at that time.

Accrued maintenance costs include (i) maintenance for work performed for off-lease aircraft, which is not related to the release of maintenance reserves received from lessees and which is expensed as incurred and (ii) lessor maintenance obligations assumed and recognized as a liability upon acquisition of aircraft subject to a lease with such provisions.

#### *(n) Recent Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09 that created the new *Topic 606* ("Topic 606") in the Accounting Standards Codification ("ASC"). Topic 606 also included numerous conforming additions and amendments to other Topics within the ASC. Topic 606 established new rules that affect the amount and timing of revenue recognition for contracts with customers, but does not affect lease accounting and reporting. As such, adoption of these provisions will not affect the Company's lease revenues but may affect the reporting of the Company's non-lease revenues. On August 12, 2015, the FASB deferred the effective date of the provisions included in Topic 606 to years commencing after December 15, 2017, although early adoption was permitted for the year ended December 31, 2017. Adoption may be reflected using either a full retrospective method, applying the standard to all periods presented, or a simplified method that does not recast prior periods but does disclose the effect of the adoption on the current period consolidated financial statements. Since most of the Company's revenues arise from its lease contracts, which are not affected by the new standard, and since the Company's revenue recognition for other sources of revenue is generally the same as it was under previous accounting standards, the Company has determined that adoption of Topic 606, using the modified retrospective approach, does not have a material effect on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 is effective for public companies for years beginning after December 15, 2018, although early adoption is permitted. ASU 2016-02 substantially modifies lessee accounting for leases, requiring that lessees recognize lease assets and liabilities for leases extending beyond one year. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement.

The new standard requires a lessor to classify leases as sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor does not convey risks and rewards or control, an operating lease results. A modified retrospective transition approach is required for lessors for sales-type, finance, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

The Company is reviewing those agreements under which it is the lessor and is evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements and related disclosures. The Company does not expect to adopt ASU 2016-02 early, and expects to elect practical expedients in connection with its adoption, including not re-evaluating lease classification or capitalized initial direct costs on existing leases.

The Company is not a lessee under any agreements that would be considered leases under ASU 2016-02, and so would be unaffected with respect to its adoption with respect to lessee accounting.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805)* ("ASU 2017-01"). ASU 2017-01 is effective for public companies for years beginning after December 15, 2017, although early adoption is permitted. ASU 2017-01 clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The Company has



early adopted ASU 2017-01 effective beginning the first quarter ended March 31, 2017 and has determined that none of its acquired assets qualifies as a business, such that no gain, loss or adjustment to the carrying value of assets was required in connection with such adoption.

In January 2017, the FASB issued ASU 2017-04, *Intangibles -- Goodwill and Other (Topic 350)* (“ASU 2017-04”), which provides for simplification of the test for goodwill impairment. Under the revised standard, “step 2” of the test under the previous standard is eliminated and (i) the fair value of the reporting unit is compared to its carrying value, with (ii) an impairment charge up to the amount of goodwill recognized for the excess of carrying value over fair value (considering the income tax effects of deductible goodwill, if applicable). The new provisions are required to be adopted for fiscal years beginning after December 15, 2019, although the Company has elected to early adopt the new provisions beginning with its quarter ended March 31, 2017. Adoption of ASU 2017-04 has had no effect on the financial results or position of the Company.

## 2. Finance Leases Receivable

During 2017, the Company leased a turboprop aircraft pursuant to a sales-type finance lease and recorded a related gain of \$297,400. The Company used cash of \$7,614,200 for the acquisition of three regional jet aircraft, which are recorded as direct financing leases.

During 2016, the Company leased three turboprop aircraft pursuant to sales-type finance leases and recorded related gains totaling \$1,208,100. The Company also recorded gains totaling \$8,600 related to the lessee’s exercise of its purchase options under two sales-type finance leases.

At December 31, 2017 and December 31, 2016, the net investment included in sales-type finance leases and direct financing leases receivable were as follows:

	December 31, 2017	December 31, 2016
Gross minimum lease payments receivable	\$27,074,400	\$20,829,200
Less unearned interest	(3,513,400)	(3,360,900)
Finance leases receivable	<u>\$23,561,000</u>	<u>\$17,468,300</u>

As of December 31, 2017, minimum future payments receivable under finance leases were as follows:

Years ending	
2018	\$ 6,262,200
2019	7,087,600
2020	5,036,600
2021	5,381,000
2022	3,307,000
	<u>\$27,074,400</u>

### 3. Aircraft and Aircraft Engines Held for Lease or Sale

#### (a) Assets Held for Lease

At December 31, 2017 and December 31, 2016, the Company's assets held for lease consisted of the following.

Type	December 31, 2017		December 31, 2016	
	Number owned	% of net book value	Number owned	% of net book value
Regional jet aircraft	13	82%	12	73%
Turboprop aircraft	10	17%	12	23%
Engines	1	1%	4	4%

During 2017 and 2016, the Company used cash of \$32,063,100 and \$54,357,600, respectively, for the purchase and capital improvement of aircraft. At the time of purchase in 2016, the Company received \$17,179,300 of maintenance reserves related to two aircraft; such reserves are reflected as a deduction in the amount of cash used for purchases and related acquisition costs in the investing activities section of the Company's statement of cash flows for the year ended December 31, 2016.

During 2017, the Company sold seven of its assets held for lease and recorded gains totaling \$704,100.

In April 2016, one of the Company's turboprop aircraft was involved in an accident and was declared a total loss by the lessee's insurer. The Company received insurance proceeds of \$17,640,000 in May 2016 and recorded a gain of \$2,146,500.

During 2017, the Company extended the leases for one of its assets held for lease. The Company also leased, and subsequently sold, an aircraft that had been off lease at December 31, 2016.

Eight of the Company's aircraft held for lease were off lease at December 31, 2017, representing 13% of the net book value of the Company's aircraft and engines held for lease. As discussed in Note 13, two of the off-lease aircraft were sold in the first quarter of 2018.

As of December 31, 2017, minimum future lease revenue payments receivable under non-cancelable operating leases were as follows:

Years ending	
2018	\$ 24,743,000
2019	24,641,300
2020	23,003,000
2021	15,901,600
2022	13,944,000
Thereafter	29,447,400
	\$131,680,300

#### (b) Assets Held for Sale

Assets held for sale at December 31, 2017 consist of turboprop airframe parts from three aircraft.

During 2017, the Company received \$193,100 from the sale of parts and accrued receivables totaling \$779,700 for 2017 parts sales, payment for which was received in 2018. Of such amounts, \$885,400 reduced the carrying value of the parts and \$87,400 was recorded as gains in excess of the carrying value of the parts. During 2016, the Company received \$178,400 from the sale of parts, of which \$175,300 reduced the carrying value of the parts and \$3,100 was recorded as a gain.

During 2016, the Company sold four regional aircraft that had been held for sale at December 31, 2015, as well as a spare engine that had been written down by \$246,200 to its net sales price and classified as held for sale. The Company recorded impairment charges totaling \$75,000 for two of the aircraft, based on a reduced sale price.

#### 4. Operating Segments

The Company operates in one business segment, the leasing of regional aircraft to foreign and domestic regional airlines, and therefore does not present separate segment information for lines of business.

Approximately 21% and 17% of the Company's operating lease revenue was derived from lessees domiciled in the United States during 2017 and 2016, respectively. All revenues relating to aircraft leased and operated internationally are denominated and payable in U.S. dollars.

The tables below set forth geographic information about the Company's operating lease revenue for leased aircraft and aircraft equipment, grouped by domicile of the lessee:

<b>Operating Lease Revenue</b>	For the Years Ended December 31,	
	2017	2016
Europe and United Kingdom	\$14,941,100	\$ 9,999,900
North America	8,506,700	6,840,500
Africa	3,306,100	4,430,300
Asia	1,251,300	1,800,400
Australia	997,500	1,140,000
Central and South America	-	253,400
	<u>\$29,002,700</u>	<u>\$24,464,500</u>
<b>Net Book Value of Aircraft and Aircraft Engines Held for Lease</b>	December 31,	
	2017	2016
Europe and United Kingdom	\$92,108,500	\$105,088,300
North America	72,270,700	42,824,300
Off lease	24,636,900	13,113,200
Asia	6,082,100	6,463,700
Africa	-	21,724,400
Australia	-	3,585,900
	<u>\$195,098,200</u>	<u>\$192,799,800</u>

The table below set forth geographic information about the Company's finance lease revenue, grouped by domicile of the lessee:

<b>Finance Lease Revenue</b>	For the Years Ended December 31,	
	2017	2016
Africa	\$ 1,180,600	\$ 868,100
United Kingdom	390,900	-
	<u>\$ 1,571,500</u>	<u>\$ 868,100</u>

## 5. Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash deposits and receivables. The Company places its deposits with financial institutions and other creditworthy issuers and limits the amount of credit exposure to any one party.

For the year ended December 31, 2017 the Company had five significant customers, four of which individually accounted for 28%, 20%, 14% and 11%, respectively, of operating lease revenue and one of which accounted for 75% of finance lease revenue. For the year ended December 31, 2016 the Company had four significant customers, three of which individually accounted for 21%, 17% and 17%, respectively, of operating lease revenue and one of which accounted for 100% of finance lease revenue.

At December 31, 2017, the Company had receivables from four customers totaling \$2,959,200 representing 77% of the Company's total accounts receivable, as well as receivables totaling \$779,700 for parts sales related to its aircraft held for sale. In early 2018, the Company received payments totaling \$3,147,600 related to these receivables.

At December 31, 2016, the Company had receivables from two customers totaling \$2,663,400 representing 78% of the Company's total accounts receivable. The Company received payment for these receivables during 2017.

## 6. Notes Payable and Accrued Interest

At December 31, 2017 and December 31, 2016, the Company's notes payable and accrued interest consisted of the following:

	December 31, 2017	December 31, 2016
Credit Facility:		
Principal	\$134,000,000	\$110,100,000
Unamortized debt issuance costs	(2,216,000)	(1,999,900)
Accrued interest	278,900	83,600
SPE Financing:		
Principal	13,511,900	17,623,600
Accrued interest	23,400	30,600
	\$145,598,200	\$125,837,900

As of December 31, 2017, principal payments due under the Company's notes payable were as follows:

Years ending	
2018	\$ 4,300,700
2019	138,498,300
2020	4,712,900
	\$147,511,900

### (a) Credit Facility

The Company's Credit Facility is provided by a syndicate of banks and is secured by all of the assets of the Company, including its aircraft and engine portfolio. In July 2017, the Credit Facility was amended to increase the total amount available for borrowing from \$150 million to \$170 million. In December 2017, the Credit Facility was amended to allow for the Company's proposed acquisition of JetFleet Holding Corp. ("JHC"), discussed in Note 7. Covenants regarding profitability, a debt to equity ratio and customer concentration were also modified.

The Credit Facility, which expires on May 31, 2019, can be expanded to a maximum of \$180 million. The Company was in compliance with all covenants under the Credit Facility at December 31, 2017 and December 31, 2016.

The unused amount of the Credit Facility was \$36,000,000 and \$39,900,000 as of December 31, 2017 and December 31, 2016, respectively. The weighted average interest rate on the Credit Facility was 5.21% and 4.15% at December 31, 2017 and December 31, 2016, respectively.

*(b) SPE Financing*

In August 2016, the Company acquired two regional jet aircraft using cash and financing separate from its Credit Facility. The separate SPE Financing resulted in note obligations totaling \$19,609,900, which are being paid from a portion of the rent payments on the related aircraft leases through October 3, 2020 and November 7, 2020, respectively, and which bear interest at the rate of 4.455% per annum. The borrower under each note obligation is the special purpose entity that owns each aircraft. The notes are collateralized by the aircraft and are recourse only to the special purpose entity borrower and its aircraft asset, subject to standard exceptions for this type of financing. Payments due under the notes consist of quarterly principal and interest. The combined balance of the notes payable and accrued interest on these notes at December 31, 2017 and December 31, 2016 was \$13,535,300 and \$17,654,200, respectively.

## **7. Acquisition of Management Company**

In October 2017, the Company and JHC entered into an Agreement and Plan of Merger (the “Merger Agreement”) for the acquisition of JHC by the Company in a reverse triangular merger (“Merger”) for consideration of \$3.5 million in cash and 129,286 shares of common stock of the Company, subject to adjustment as provided in the Merger Agreement. The Company submitted an application to the State of California Department of Business Oversight (the “DBO”) for a permit (“Permit”) to issue securities to JHC’s shareholders in the Merger, which Permit was issued on February 22, 2018 after a hearing with the DBO. It is anticipated that the closing will occur early in the second quarter of 2018, upon the fulfillment of several conditions, including votes in favor of the Merger by certain specified constituencies of JHC shareholders. The Company is evaluating the accounting for the Merger.

During the year ended December 31, 2017, the Company accrued \$619,400 of expenses related to the proposed Merger transaction. Such expenses are included in professional fees, general and administrative and other in the Company’s consolidated statements of operations.

## **8. Contingencies**

In the ordinary conduct of the Company’s business, the Company is subject to lawsuits, arbitrations and administrative proceedings from time to time. The Company believes that the outcome of any existing or known threatened proceedings, even if determined adversely, should not have a material adverse effect on the Company’s business, financial condition, liquidity or results of operations.

## **9. Stockholder Rights Plan**

In December 2009, the Company’s Board of Directors adopted a stockholder rights plan granting a dividend of one stock purchase right for each share of the Company’s common stock outstanding as of December 18, 2009 and the Company entered into a rights agreement dated December 1, 2009 in connection therewith. The rights become exercisable only upon the occurrence of certain events specified in the rights agreement, including the acquisition of 15% of the Company’s outstanding common stock by a person or group in certain circumstances. Each right allows the holder, other than an “acquiring person,” to purchase one one-hundredth of a share (a unit) of Series A Preferred Stock at an initial purchase price of \$97.00 under circumstances described in the rights agreement. The purchase price, the number of units of preferred stock and the type of securities issuable upon exercise of the rights are subject to adjustment. The rights expire at the close of business December 1, 2019 unless earlier redeemed or exchanged. Until a right is exercised, the holder thereof, as such, has no rights as a stockholder of the Company, including the right to vote or to receive dividends.



## 10. Income Taxes

The items comprising the income tax provision are as follows:

	For the Years Ended December 31,	
	2017	2016
Current tax provision:		
Federal	\$ -	\$ -
State	800	800
Foreign	329,500	123,200
Current tax provision	330,300	124,000
Deferred tax provision/(benefit):		
Federal	1,159,700	626,700
State	35,100	45,100
Foreign	(111,300)	(45,500)
Net legislative change in corporate tax rate	(5,380,300)	-
Deferred tax (benefit)/provision	(4,296,800)	626,300
Total income tax (benefit)/provision	\$(3,966,500)	\$750,300

Total income tax (benefit)/expense differs from the amount that would be provided by applying the statutory federal income tax rate to pretax earnings as illustrated below:

	For the Years Ended December 31,	
	2017	2016
Income tax provision at statutory federal income tax rate	\$ 1,167,100	\$670,500
State tax provision, net of federal benefit	33,100	45,200
Non-deductible expenses	213,500	34,600
Net legislative change in corporate tax rate	(5,380,200)	-
Total income tax (benefit)/provision	\$(3,966,500)	\$750,300

Temporary differences and carry-forwards that give rise to a significant portion of deferred tax assets and liabilities as of December 31, 2017 and 2016 were as follows:

	December 31,	
	2017	2016
Deferred tax assets:		
Maintenance reserves	\$ 2,810,200	\$ 6,846,800
Current and prior year tax losses	3,362,100	4,016,000
Foreign tax credit	295,800	77,700
Alternative minimum tax credit	45,500	45,500
Deferred maintenance, bad debt allowance and other	38,800	62,100
Deferred tax assets	6,552,400	11,048,100
Deferred tax liabilities:		
Accumulated depreciation on aircraft and aircraft engines	(14,591,000)	(23,012,800)
Deferred income	(495,100)	(865,800)
Net deferred tax liabilities	\$(8,533,700)	\$(12,830,500)

Deferred federal income taxes arise from temporary differences between the valuation of assets and liabilities as determined for financial reporting purposes and federal income tax purposes and are measured at enacted tax rates. As of December 31, 2016, the Company measured its deferred tax items at an effective federal tax rate of 34%. On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Act") was signed into law. Among other things, the Act reduced the Company's corporate federal tax rate to a flat 21% for years after 2017. As a result, the Company's deferred tax items

are measured at an effective federal tax rate of 21% as of December 31, 2017. Although realization is not assured, management believes it is more likely than not that the entire deferred federal income tax asset will be realized. The amount of the deferred federal income tax assets considered realizable could be reduced in the near term if estimates of future taxable income are reduced.

The current year federal operating loss carryovers of approximately \$16 million will be available to offset taxable income in future years through 2037 (and would be available in the two preceding years if the Company had taxable income in such years). The current year state operating loss carryovers of approximately \$62,000 will be available to offset taxable income in the two preceding years and in future years through 2037. The Company expects to utilize the net operating loss carryovers remaining at December 31, 2017 in future years.

Utilization of the domestic NOLs may be subject to a substantial annual limitation due to ownership change limitations that may have occurred or that could occur in the future, as required by the Internal Revenue Code Section 382, as well as similar state provisions. In general, an “ownership change,” as defined by the code, results from a transaction or series of transactions over a three-year period resulting in an ownership change of more than 50 percentage points of the outstanding stock of a company by certain stockholders or public groups. Any limitation may result in expiration of all or a portion of the NOL or tax credit carryforwards before utilization.

During the year ended December 31, 2017, the Company had pre-tax income from domestic sources of approximately \$2.2 million and pre-tax income from foreign sources of approximately \$1.2 million. The Company had pre-tax income from domestic sources of approximately \$1.6 million and pre-tax income from foreign sources of approximately \$388,000 for the year ended December 31, 2016. The foreign tax credit carryover will be available to offset federal tax expense in future years through 2027.

The Act repeals the corporate alternative minimum tax for tax years beginning after 2017. In addition, beginning in 2018, the Company’s alternative minimum tax credit (“MTC”) will be available to offset federal tax expense and is refundable in an amount equal to 50% of the excess MTC for the tax year over the amount of the credit allowable for the year against regular tax liability. In 2021, any remaining MTC will be fully refundable.

At December 31, 2017 and December 31, 2016, the Company had no material uncertain tax positions.

The Company accounts for interest related to uncertain tax positions as interest expense, and for income tax penalties as tax expense.

All of the Company’s tax years remain open to examination other than as barred in the various jurisdictions by statutes of limitation.

## 11. Computation of Earnings Per Share

Basic and diluted earnings per share are calculated as follows:

	For the Years Ended December 31,	
	2017	2016
Net income	\$7,399,200	\$1,221,700
Weighted average shares outstanding for the period	1,449,576	1,566,699
Basic earnings per share	\$ 5.10	\$ 0.78
Diluted earnings per share	\$ 5.10	\$ 0.78

Basic earnings per common share is computed using net income and the weighted average number of common shares outstanding during the period. Diluted earnings per common share are computed using net income and the weighted average number of common shares outstanding, assuming dilution. Weighted average common shares outstanding, assuming dilution, include potentially dilutive common shares outstanding during the period, of which the Company had none during 2017 and 2016.

## 12. Related Party Transactions

The Company's portfolio of leased aircraft assets is managed and administered under the terms of the Management Agreement with JMC, which is an integrated aircraft management, marketing and financing business and a subsidiary of JHC. Certain officers of the Company are also officers of JHC and JMC and hold significant ownership positions in both JHC and the Company.

Under the Management Agreement, JMC receives a monthly management fee based on the net asset value of the assets under management. JMC also receives an acquisition fee for locating assets for the Company. Acquisition fees are included in the cost basis of the asset purchased. JMC may receive a remarketing fee in connection with the re-lease or sale of the Company's assets. Remarketing fees are amortized over the applicable lease term or included in the gain or loss on sale. If the Merger is consummated, then the current JMC management fee structure will cease, but the costs previously borne by JMC in managing the Company's assets will be borne by the Company and will not be limited to the management fee amount, as was the case when the Management Agreement was in place.

Fees incurred during 2017 and 2016 were as follows:

	For the Years Ended December 31,	
	2017	2016
Management fees	\$6,109,200	\$5,204,500
Acquisition fees	850,500	1,124,200
Remarketing fees	51,100	284,500

See the discussion in Note 7 regarding the Agreement and Plan of Merger for the acquisition of JHC by the Company.

In August 2009, the Company entered into an agreement (the "Assignment Agreement") with Lee G. Beaumont in which Mr. Beaumont assigned to the Company his rights to purchase certain aircraft engines from an unrelated third party seller. In January 2012, Mr. Beaumont became a "related person" with respect to the Company due to his open market acquisitions of shares representing over 5% of the Company's common stock. In March 2017, the Company exchanged one of its engines for 150,000 shares of common stock of the Company held by Mr. Beaumont. The Company recorded no gain or loss related to the exchange.

## 13. Subsequent Events

In January 2018, the Company sold a turboprop aircraft and recorded a gain of approximately \$47,000.

In February 2018, the Company sold a turboprop aircraft that had been written down to its net sales value at December 31, 2017.

On February 22, 2018, the DBO held a hearing regarding the Merger transaction pursuant to Section 25142 of the California Corporations Code, to determine whether the terms and conditions of the issuance of the Company's shares of Common Stock in the Merger to JHC's shareholders are fair. Following the hearing, a permit was issued by the DBO, which will allow the issuance of the Company's common stock in the Merger transaction to be exempt from federal securities registration under Section 3(a)(10) of the Securities Act. The Company is currently in the process of soliciting the consent of the JHC shareholders to the Merger which is one of the material conditions precedent to the closing of the Merger transaction.

## **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

### **Item 9A. Controls and Procedures.**

**CEO and CFO Certifications.** Attached as exhibits to this Annual Report on Form 10-K (the “Report”) are certifications of the Company’s Chief Executive Officer (the “CEO”) and the Company’s Chief Financial Officer (the “CFO”), which are required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (the “Section 302 Certifications”). This section of the Report includes information concerning the evaluation of disclosure controls and procedures referred to in the Section 302 Certifications and this should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics presented.

**Evaluation of the Company’s Disclosure Controls and Procedures.** Disclosure controls and procedures (the “Disclosure Controls”) are controls and other procedures that are designed to ensure that information required to be disclosed in the Company’s reports filed under the Securities Exchange Act of 1934 (the “Exchange Act”), such as this Report, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (the “SEC”) and that such information is accumulated and communicated to the Company’s management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

The Company’s management, with the participation of the CEO and CFO, evaluated the effectiveness of the design and operation of the Company’s Disclosure Controls and concluded that the Company’s Disclosure Controls were effective as of December 31, 2017.

**Management’s Annual Report on the Company’s Internal Control Over Financial Reporting.** Internal control over financial reporting (“Internal Control”) is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements. The Company’s management is responsible for establishing and maintaining adequate Internal Control. Because of its inherent limitations, any system of internal control over financial reporting, no matter how well designed, may not prevent or detect misstatements due to the possibility that a control can be circumvented or overridden or that misstatements due to error or fraud may occur that are not detected. Also, because of changes in conditions, internal control effectiveness may vary over time.

Management evaluated the Company’s Internal Control based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework (2013)* and concluded that the Company’s Internal Control was effective as of December 31, 2017. This report does not include an attestation report on Internal Control by the Company’s independent registered public accounting firm since the Company is a smaller reporting company under the rules of the SEC.

**Changes in Internal Control Over Financial Reporting.** No change in Internal Control occurred during the fiscal quarter ended December 31, 2017 that has materially affected, or is reasonably likely to materially affect, the Company’s Internal Control.

### **Item 9B. Other Information.**

None.

## **PART III**

### **Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by this item is included under (i) “Proposal 1: Election of Directors” as it relates to members of the Company’s Board of Directors, including the Company’s Audit Committee and the Company’s Audit Committee financial experts, any changes to procedures by which security holders may recommend nominees to the Company’s Board of Directors, (ii) “Information Regarding the Company’s Directors and Officers” as it relates to the Company’s executive officers, and (iii) “Section 16(a) Beneficial Ownership Reporting Compliance” as it relates to information concerning Section 16(a) beneficial ownership reporting compliance, in the Company’s definitive proxy statement (“Proxy Statement”), to be filed in connection with the Company’s 2018 Annual Meeting of Stockholders, and is incorporated herein by reference.

The Company has adopted a code of business conduct and ethics, or code of conduct. The code of conduct qualifies as a “code of ethics” within the meaning of Section 406 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder. A copy of the code of conduct is available on the Company’s website at <http://www.aerocentury.com> or upon written request to the Investor Relations Department, 1440 Chapin Avenue, Suite 310, Burlingame, California 94010. To the extent required by law, any amendments to, or waivers from, any provision of the code will be promptly disclosed publicly. To the extent permitted by such requirements, the Company intends to make such public disclosure on its website in accordance with SEC rules.

### **Item 11. Executive Compensation.**

Incorporated by reference to the section of the Proxy Statement entitled “Information Regarding the Company’s Directors and Officers — Employee Compensation.”

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

Incorporated by reference to the section of the Proxy Statement entitled “Security Ownership of Certain Beneficial Owners and Management.”

### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

Incorporated by reference to the section of the Proxy Statement entitled “Related Party Transactions.”

### **Item 14. Principal Accountant Fees and Services.**

Incorporated by reference to the section of the Proxy Statement entitled “Information Regarding Auditors – Audit Fees.”



## PART IV

### Item 15. Exhibits.

(b) Exhibits

<u>Exhibit Number</u>	<u>Description</u>
10.37	Agreement and Plan of Merger, dated as of October 26, 2017, by and among the AeroCentury Corp., Falcon Landing, Inc., JHC Holding Corp., and Fortis Advisors LLC, incorporated herein by reference to Exhibit 2.1 to the Company's Report on Form 8-K filed with the Securities and Exchange Commission on October 30, 2017
10.38	Fifth Modification Agreement between the Company and MUFG Union Bank, N.A., as Lender and Swing Line Lender, and as Agent, California Bank & Trust, a division of ZB, N.A., Columbia State Bank, Umpqua Bank, U.S. Bank National Association, and Columbia State Bank, dated December 20, 2017, incorporated herein by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed with the Securities and Exchange Commission on December 21, 2017
31.1	Certification of Michael G. Magnusson, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Toni M. Perazzo, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Michael G. Magnusson Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Toni M. Perazzo, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

\* These certificates are furnished to, but shall not be deemed to be filed with, the Securities and Exchange Commission.

### Item 16. Form 10-K Summary.

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### AEROCENTURY CORP.

By

/s/ Toni M. Perazzo

Toni M. Perazzo

Senior Vice President-Finance and  
Chief Financial Officer

Date            March 8, 2018

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Toni M. Perazzo, or her attorneys-in-fact, with the power of substitution, for her in any and all capacities, to sign any amendments to this Report on Form 10K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact, or her substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated.

<u>Signature</u>	<u>Title</u>	<u>Dated</u>
/s/ Michael G. Magnusson Michael G. Magnusson	President of the Registrant (Principal Executive Officer)	March 8, 2018
/s/ Toni M. Perazzo Toni M. Perazzo	Director and Senior Vice President-Finance and Secretary of the Registrant (Principal Financial and Accounting Officer)	March 8, 2018
/s/ Evan M. Wallach Evan M. Wallach	Director and Chairman of the Board of Directors of the Registrant	March 8, 2018
/s/ Roy E. Hahn Roy E. Hahn	Director	March 8, 2018
/s/ Karen M. Rogge Karen M. Rogge	Director	March 8, 2018
/s/ David P. Wilson David P. Wilson	Director	March 8, 2018

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## CORPORATE INFORMATION

### Officers and Directors

**Michael G. Magnusson**

President

**Toni M. Perazzo**

Director, Chief Financial Officer, Secretary, and  
Senior Vice President — Finance

**Christopher B. Tigno**

General Counsel

**Roy E. Hahn**

Director, Audit Committee Chair  
Managing Director of Marbridge Group, LLC

**Karen M. Rogge**

Director  
President of RYN Group LLC

**Evan M. Wallach**

Chairman of the Board  
President and Chief Executive Officer of  
Global Airfinance Corporation

**David P. Wilson**

Director, Compensation Committee Chair  
Retired Senior Vice President of  
GE Capital Aviation Services

**Transfer Agent and Registrar**

Continental Stock Transfer and Trust Company  
17 Battery Place, 8th Floor  
New York, NY 10004

**Legal Counsel**

Morrison & Foerster LLP  
755 Page Mill Road  
Palo Alto, CA 94304

**Registered Independent Public Accountants**

BDO USA, LLP  
One Bush Street, Suite 1800  
San Francisco, CA 94104

**Corporate Headquarters**

AeroCentury Corp.  
1440 Chapin Ave., Suite 310  
Burlingame, CA 94010

**Annual Meeting**

The Annual Meeting of Stockholders will be held at:  
The Hiller Aviation Museum  
601 Skyway Road  
San Carlos, CA, on May 3, 2018 at 12:00 P.M.

**Form 10-K**

The Company's Annual Report on Form 10-K  
for 2017 may be obtained by writing:  
AeroCentury Corp.  
1440 Chapin Ave., Suite 310  
Burlingame, CA 94010

**Stock Price and Shareholder Data**

The Company's common stock is traded on  
the NYSE American exchange under  
the symbol ACY.



**AeroCentury Corp.**  
1440 Chapin Avenue  
Suite 310  
Burlingame, CA 94010

Phone: 650.340.1888

[www.AeroCentury.com](http://www.AeroCentury.com)